HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/HB 445 Viatical Settlements
SPONSOR(S): Insurance & Banking Subcommittee; Stevenson
TIED BILLS: **IDEN./SIM. BILLS:** SB 650

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Insurance & Banking Subcommittee	10 Y, 1 N, As CS	Bauer	Luczynski
2) Appropriations Committee			
3) Regulatory Affairs Committee			

SUMMARY ANALYSIS

An *insurable interest* exists for purposes of life insurance when a policyholder has a reasonable expectation that he or she will benefit from the continued life and health of the insured person. In Florida, it is recognized that an individual has an insurable interest as to his or her own life, body, and health, and that other persons with a "love and affection" or pecuniary relationship to the insured (such as family members or a corporate employer) also have valid insurable interests. It has long been recognized in American jurisprudence that life insurance policies purchased without an insurable interest (i.e., on strangers) violate public policy, because they constitute a mere wager on human lives that creates a perverse desire for the early death of the insured. In some instances, life insurance policyholders may wish to sell their policies to third parties as a way to obtain cash for medical expenses or other needs. In these transactions, known as *viatical settlements*, companies called *viatical settlement providers* (VSPs) purchase the policy from the insured (*the viator*) for more than its cash surrender value, but less than the face value of the policy. In 1996, Florida established a regulatory framework of the viatical settlement industry in the Viatical Settlement Act in part X, ch. 626, F.S. ("the Act"), which is administered by the Office of Insurance Regulation (OIR). The Act requires VSPs to comply with licensure, annual reporting, anti-fraud, transactional, and disclosure provisions, and sets forth administrative, criminal, and civil penalties for violations of the Act.

In the early 2000s, a related product known as "stranger-originated life insurance" (also known as STOLI) emerged. While STOLI initially appears similar to legitimate viatical settlements, STOLI is a scheme designed to procure life insurance on individuals, often using fraudulent means, such as misrepresentation, falsification, or omission of material facts in the life insurance application, so that an assignment or sale of a policy functions as a subterfuge that circumvents the insurable interest requirement. While various provisions in the Act and the Insurance Code currently prohibit practices that may involve STOLI, they do not specifically address STOLI.

The bill amends the Act to specifically define STOLI as a "fraudulent viatical settlement act," to prohibit STOLI as a practice that lacks an insurable interest in the insured at the time of policy origination, and to make STOLI void and unenforceable. Additionally, the bill:

- Increases maximum administrative fines that the OIR may impose for certain violations, increases the $100,000 deposit requirement to $250,000, and creates new felony offenses for certain viatical settlement practices;
- Establishes new disclosure and annual reporting requirements and conflicts of interest prohibitions for VSPs;
- Requires VSPs to file their advertising and marketing materials with the OIR prior to entering into viatical contracts and to maintain documentation of compliance with their anti-fraud plans;
- Increases the non-contestability period from two years to five years, subject to certain exceptions; and
- Requires VSPs to provide certain documentation to insurers for verification of coverage, prior to entering into a viatical settlement contract.

The bill has an indeterminate impact on state government, in that it increases administrative fines for violations of the Act, and requires the OIR to review VSPs' advertising materials. The Criminal Justice Impact Conference has not yet met to determine the prison bed impact of the bill. The bill has no impact on local governments. While the bill increases regulatory requirements and administrative fines on VSPs, the bill may have a positive effect on consumers and life insurers by strengthening consumer protections and reducing fraudulent life insurance claims and litigation.

The bill has an effective date of July 1, 2016.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Life Insurance and the Insurable Interest Requirement

Life insurance allows an individual to set aside money in the present (through the payment of premiums) to provide some measure of financial security for his or her surviving beneficiaries upon his or her premature death. The proceeds allow survivors to pay off debts and other expenses and provide a source of income to replace that lost by the death of the insured.[1] Life insurance dates to ancient Rome where burial clubs covered the cost of members' funeral expenses and provided monetary benefits to survivors. Modern life insurance became commercially important in the 15th century Mediterranean mercantile economies and through its introduction to England in the 16th century. Although it served a legitimate purpose of risk avoidance and mitigation, life insurance drew a strong appeal to the gambling instincts of middle-class individuals with no financial interest in the lives of popes, princes, and other prominent people and who took out insurance policies on these strangers' lives as mere wagers. To put an end to the use of life insurance contracts as wagering devices, the British Parliament enacted the Life Assurance Act of 1774, holding that any life insurance contract without an *insurable interest* in the life of the insured would be null and void.[2]

In the late 19th century, the U.S. Supreme Court defined "insurable interest" as "a reasonable expectation of advantage or benefit from the continuance of [the insured's] life"; in other words, an insurable interest is found when an individual has a greater interest in the survival of the insured than in the insured's death.[3] Subsequently, most American courts recognized the insurable interest requirement for life insurance policies, finding that life insurance policies purchased without an insurable interest violate public policy because they constitute a mere wager that creates a sinister desire for the early death of the insured.[4] Today, it is recognized that an individual has an insurable interest as to his or her own life, body, and health. In addition, an insurable interest is founded on a "love and affection" interest for persons related by blood or law; as to other persons, a lawful and substantial economic interest in the continued life, health, or bodily safety of the insured person,[5] such as corporate-owned insurance on the life of an officer or director. These recognized interests are intended to ensure life insurance's purpose as a financial protection tool, rather than a wagering device.

Florida's insurable interest requirement is codified at s. 627.404, F.S., which lists nine exclusive categories in which an insurable interest as to life, health, or disability insurance are recognized, including the "own life, body and health," "love and affection," and "substantial pecuniary advantage" grounds mentioned above.[6] The statute requires that an insurable interest exist at the time the insurance contract is made, but need not exist after the inception date of coverage under the contract. Thereafter, life insurance is an asset that may be freely sold, transferred, or devised, which is consistent with the parties' freedom to contract for the assignment or non-assignment of policies in s. 627.422, F.S.

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[1] OFFICE OF INSURANCE REGULATION, *Life Insurance*, http://www.floir.com/Sections/LandH/Life/default.aspx (last viewed Dec. 7, 2015).

[2] Susan Lorde Martin, *Betting on the Lives of Strangers: Life Settlements, STOLI, and Securitization*, 13 U. PA. J. BUS. L. 173, 174 (2010); OFFICE OF INSURANCE REGULATION, *Report of Commissioner Kevin M. McCarty: Stranger-Originated Life Insurance and the Use of Fraudulent Activity to Circumvent the Intent of Florida's Insurable Interest Law* (Jan. 2009), ("2009 OIR Report"), p. 6.

[3] *Warnock v. Davis*, 104 U.S. 775, 779 (1881); *Connecticut Mut. Life Ins. Co. v. Schaefer*, 94 U.S. 457, 460 (1876).

[4] *Id.*; *Aetna Life Ins. Co. v. France*, 94 U.S. 561 (1876) and *Grigsby v. Russell*, 222 U.S. 149 (1911).

[5] OFFICE OF INSURANCE REGULATION, *Report of Commissioner Kevin M. McCarty: Stranger-Originated Life Insurance and the Use of Fraudulent Activity to Circumvent the Intent of Florida's Insurable Interest Law* (Jan. 2009), ("2009 OIR Report"), p. 7.

[6] These grounds were added to s. 627.404, F.S., by the Florida Legislature in 2008. Ch. 2008-36, Laws of Fla.

Viatical Settlements: The Secondary Market of Life Insurance

In some instances, life insurance policyholders seek to sell their policies to third parties (usually private, individual investors) as a way to obtain cash for medical expenses or other needs. In these transactions, known as "viatical settlements," companies called *viatical settlement providers* would usually purchase the policy from the insured (*the viator*) for more than its cash surrender value, but less than the face value of the policy. The settlement is usually based upon the projected life expectancy of the insured, the amount of built-up cash in the policy, and other criteria, and is often negotiated by a *viatical settlement broker* on the viator's behalf. The purchaser of the policy then pays the premiums to sustain the policy until the insured's death; as a result, the sooner the viator was the expected to die, the higher the settlement offer is likely to be.

Viatical settlements emerged during the HIV/AIDS epidemic in the 1980s, enabling terminally ill patients with short life expectancies who could no longer work and afford the policy premiums to sell their life insurance policies at a cash discount to pay for high medical care expenses. In the early days of the epidemic, AIDS patients generally died within months of their diagnoses, resulting in fairly quick, significant returns to investors,[7] who in those days were typically senior individuals who risked their savings in what was represented as a safe investment and marketed as a compassionate way to help dying patients. However, innovations in AIDS treatment in the early 1990s significantly improved life expectancies of AIDS patients, sometimes even outliving their investors, which disrupted mortality assumptions and diminished investor returns. As a result, some viatical settlement providers stopped brokering new viatical settlements, while others engaged in fraudulent practices, such as pyramid schemes.[8]

Because investors' expectations of returns can trigger the application of state and federal securities law, viatical settlements are widely treated as a hybrid transaction implicating both insurance law and securities law. *Insurance* law applies to protect the policy owner or viator in the "front-end" transaction with the viatical settlement provider through licensing, disclosure reporting, and other requirements. On the other hand, *securities* law applies to the "back-end" transaction to protect investors in viatical settlement investments by state securities regulators, and in some circumstances, the U.S. Securities and Exchange Commission.[9]

In response to increasing concerns over consumer protection in the viatical settlement market, several state insurance regulators (through the National Association of Insurance Commissioners (NAIC)) and the National Association of Insurance Legislators (NCOIL)[10] developed model state legislation regulating the "front-end" transaction of viatical settlements in 1993 and 2007, respectively.

Regulation of Viatical Settlements in Florida

In 1996, Florida enacted the Viatical Settlement Act (codified as part X, ch. 626, F.S.; "the Act")[11] as a regulatory framework for viatical settlement providers (VSPs) and viatical settlement brokers by the Department of Insurance, the predecessor agency to the current Office of Insurance Regulation (OIR).[12] The Act sets forth requirements for licensure, annual reporting, certain minimum disclosures to viators, transactional procedures, adoption of anti-fraud plans, and administrative, civil, and criminal

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[7] Kelly J. Bozanic, *An Investment to Die For: From Life Insurance to Death Bonds, the Evolution and Legality of the Life Settlement Industry*, 113 PENN. ST. L. REV. 229, 233-234 (2008).
[8] OFFICE OF INSURANCE REGULATION, *Secondary Life Insurance Market Report to the Florida Legislature* (Dec. 2013) ("2013 OIR Report"), p. 9.
[9] GOVERNMENT ACCOUNTABILITY OFFICE, Report to the Special Committee on Aging, U.S. Senate: Life Insurance Settlements, GAO-10-775 (Jul. 2010), p. 9, at http://www.gao.gov/assets/310/306966.pdf .
[10] The NAIC is the standard-setting and regulatory support organization created and governed by the chief insurance departments that regulate the conduct and solvency of insurers in their respective states or territories. NAIC, *About the NAIC*, http://www.naic.org/index_about.htm (last visited Dec. 29, 2015).
[11] Ch. 96-336, Laws of Fla.
[12] Following the 2003 governmental reorganization, authority over the Act was transferred to the OIR. Ch. 2003-261, Laws of Fla. Additionally, the Act requires *life expectancy providers* to register with the OIR. Life expectancy providers determine life expectancies or mortality ratings for viatical settlements. ss. 626.9911(4) and 626.99175, F.S.

penalties. The Act also provides the OIR with examination and enforcement authority over VSPs and brokers; review and approval authority over the viatical settlement contracts and forms; rulemaking authority; and provided that a violation of the Act is an unfair trade practice under the Insurance Code. The Act does not authorize the OIR to regulate the rate or amount paid as consideration for a viatical settlement contract.[13]

Since its inception, the Act has been substantively amended seven times to enhance consumer protections and to address changes in the viatical settlement industry.[14] For example, prior to July 1, 2005, viaticals in Florida were regulated exclusively as insurance. In 2005, following numerous consumer complaints and findings of investor harm in the "back-end transaction," the Legislature amended the Act to provide that *viatical settlement investments* are securities under the Florida Securities and Investor Protection Act (ch. 517, F.S.), which is enforced by the Office of Financial Regulation (OFR) and triggers requirements of full and fair disclosure to investors and a securities dealer license from the OFR.[15] The 2005 legislation also provides that a person or firm who offers or attempts to negotiate a viatical settlement between an insured (viator) and a VSP for compensation is a *viatical settlement broker* who must be licensed with the Department of Financial Services (DFS) as a life insurance agent with a proper appointment from a VSP. Viatical settlement brokers owe a fiduciary duty to the viator.[16]

Since the inception of the Act, the viatical settlement market has evolved both in terms of the types of policies transacted by viatical settlement providers and the type of investors.

- "Life settlements" are offered to non-terminally ill insureds that no longer want, need, or can afford their policies and as an alternative to exercising a redemption or accelerated death benefit clause in their policies. However, the Act treats life settlements the same as viatical settlements for purposes of regulation.[17]
- Additionally, instead of the private individuals who invested in viaticals during the HIV/AIDS epidemic, institutional investors (such as investment banks and hedge or pension funds) now often invest in large blocks of policies sold as a portfolio in the secondary market.[18] In 2013, the Legislature directed the OIR to review Florida law and regulations to determine whether there were adequate protections for purchasers of life insurance policies in the secondary life insurance market.[19] Following a public hearing conducted by the OIR, in which both life insurers and institutional investors participated, the OIR published a report, concluding that adequate protections for institutional purchasers in the secondary life insurance market existed and that their recommendations did not warrant legislative action at the time.[20]

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[13] s. 626.9926, F.S.
[14] Excluding reviser's bills and the 2003 governmental reorganization bill. *See* chs. 98-164; 99-212; 2000-344; 2001-207; 2001-247; 2005-237; and 2007-148, Laws of Fla.
[15] Ch. 2005-237, Laws of Fla.
[16] ss. 626.9911(9) and 626.9916, F.S.
[17] The 2000 legislation amended the definition of "viator," who is the owner of a life insurance policy seeking to enter into a viatical settlement contract, to remove language restricting such policy to one "insuring the life of an individual with a catastrophic or life-threatening illness." *See* ch. 2000-344, Laws of Fla.
[18] 2013 OIR REPORT, p. 13. One participant in the 2013 OIR hearing observed that institutional investors primarily participate in the securitization of life settlements, or the nominal "tertiary" market, which feeds liquidity into the secondary life insurance market (i.e., the subsequent trading after the policy is first sold). *Id.* at Appendix A, Transcript of Public Hearing, pp. 125-126.
[19] Ch. 2013-40, §6, Laws of Fla. (2013 General Appropriations Act, p. 316).
[20] 2013 OIR REPORT, pp. 50-51.

Stranger-Originated Life Insurance (STOLI)

Another evolution of the viatical settlement market is a practice known as "stranger-originated (or stranger-owned) life insurance" (STOLI), which emerged in the 2000s. In a STOLI transaction, an individual (typically a senior) is encouraged to take out insurance on his or her own life, sometimes in the millions of dollars, and then assigns the policy to an investor or group of investors (the "stranger") who pay the individual a large cash settlement in exchange for the ownership rights to the policy, including the right to receive the proceeds upon the insured's death.

On the surface, STOLI may appear similar to legitimate viatical or life settlements in that a third party buys a policy from an insured in which they have no insurable interest. However, the critical difference is that in legitimate settlements, an insured initially buys life insurance in a good-faith intent to protect valid insurable interests (i.e., to protect family members or a business from the risk of a premature death), but subsequently decides to sell the policy to a third party due to a change in circumstances that may not warrant the policy (such as divorce, death of an intended beneficiary, or the need for immediate cash due to illness or other loss).

Unlike legitimate viaticals, STOLI lacks an insurable interest at the time of the contract, thereby violating public policy against wagering on the lives of others. The life insurance policy is not acquired in good faith in that the parties intend at the outset that the *investors* (who lack an insurable interest in the insured) receive the proceeds, directly or indirectly.[21] STOLI is a scheme designed to procure life insurance on individuals, often using fraudulent means, such as misrepresentation, falsification, or omission of material facts in the life insurance application, so that an assignment or sale of a policy functions as a subterfuge that circumvents the insurable interest requirement. As the Uniform Law Commission noted:

> Those who benefit from STOLI transactions (typically investors in the secondary markets) claim that it is an appropriate use of life insurance consistent with applicable legal principles, including the free transferability of assets. Others, including life insurers, oppose the use of STOLI on the ground that is a perversion of the life insurance asset and leads to the moral hazard concerns that insurable interest doctrines were intended to mitigate.[22]

STOLI also differs from legitimate viatical settlements with the following common characteristics:

- Typically targets senior citizens who are induced with gifts, promises of free insurance, or monetary gain;
- Commonly financed through non-recourse "premium finance loans";
- Commonly structured through the use of an irrevocable trust, making it difficult for the life insurance company to know that the policy has been sold;
- Premiums are paid for two years (i.e., the contestable period); and
- Often involves misrepresentation, falsification, or omission of material facts (also known as "cleansheeting") in the life insurance application and inflated underwriting practices, such as the applicant's net worth, in order to obtain a policy with a high face value.

According to the OIR, STOLI impacts consumers (both individual investors and insureds) and insurers in a number of ways:[23]

- Seniors may exhaust their life insurance purchasing capability and not be able to protect their own family or business.

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[21] AALU, NAIFA, and ACLI, *STOLI: The Problem and the Appropriate State Response*, p. 4, on file with the Insurance & Banking Subcommittee staff.

[22] UNIFORM LAW COMMISSION, *Insurable Interest Amendment to the Uniform Trust Code Summary*, at http://www.uniformlaws.org/ActSummary.aspx?title=Insurable%20Interests%20Amendment%20to%20the%20Uniform%20Trust%20Code (last visited Dec. 28, 2015).

[23] Office of Insurance Regulation, Agency Analysis of 2016 House Bill 445 ("OIR Agency Analysis"), p. 6 (Nov. 15, 2015); Additionally, s. 626.9923, F.S., requires VSPs to disclose certain risks to viators, such as tax and Medicaid eligibility consequences.

- The incentives, especially cash payments, used to lure seniors to participate in STOLI schemes are taxable as ordinary income.
- Seniors may subject themselves or their estates to potential liability in the event the life insurance policy is rescinded by an insurer who discovers fraud.
- Seniors may encounter unexpected tax liability from the sale of the life insurance policy.[24]
- The "free" insurance is not free and may be subject to tax based on the economic value of the coverage.
- Seniors have to give the purchaser, and subsequent purchasers, access to their medical records when they sell their life insurance policy in the secondary market so that investors know the health status of the insured. The investors want to know the "status" of their investment and how close they are to getting paid.
- STOLI may lead to an increase in life insurance rates for the over-65 population.
- If STOLI practices continue to proliferate, the U.S. Congress may remove the tax-free status of life insurance proceeds, or may provide for federal regulatory oversight of the viatical settlement industry.

Legislative, Regulatory, and Litigation Approaches to STOLI

Over 30 states currently prohibit STOLI, generally through some combination of the NAIC and NCOIL model acts, in addition to common law or statutory insurable interest laws. STOLI has resulted in significant litigation, criminal and regulatory enforcement actions, both nationally and in Florida.[25]

Below are several legal grounds currently available to the OIR and life insurers in STOLI transactions:

- *Grounds for disciplinary action under the Act*: Currently, the Act authorizes the OIR to impose fines between $2,500 to $10,000, or to suspend, revoke, deny, or refuse to renew the license of any VSP found to be engaging in certain acts, such as fraudulent or dishonest practices, dealing in bad faith with viators, or violating any provision of the Act or the Insurance Code. The OIR may also impose cease and desist orders and immediate final orders for violations of the Act.[26]
- *Misrepresentation on an application*: Currently, s. 627.409, F.S., provides that misrepresentation, omission, concealment of fact, or incorrect statements on an application for an insurance contract "may prevent recovery" in certain cases. However, this remedy is viewed as inadequate, because there are no criminal penalties and the only civil penalty available is an action for rescission by the life insurer.
- *Agent regulation*: Various provisions of the Insurance Code authorize the DFS to suspend or revoke the license or appointment of licensees, agencies, or appointees on various grounds, such as using fraudulent or dishonest practices in the conduct of business under the license.[27]
- *Unfair Insurance Trade Practices Act*: Section 626.9541, F.S., lists several unfair methods of competition and unfair or deceptive acts or practices. Each violation of this statute can result in fines ranging from $5,000 to $75,000, depending on the willfulness and particular violation. In addition, "twisting" and "churning" are first-degree misdemeanors, while willfully submitting false signatures on an application is a third-degree felony.[28] While VSPs are subject to this statute by way of s. 626.9927, F.S., and STOLI transactions do share some components of these practices, the statute was written for the initial sale of an insurance policy to an insured and not specifically for STOLI, making it difficult and unwieldy for the OIR to apply the provisions to secondary sales of life insurance policies.[29]

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[24] *See* IRS Rev. Ruls. 09-13 and 09-14, regarding taxation of proceeds from settlements as capital gains ordinary income and taxation on a post-settlement basis.
[25] For a listing of OIR enforcement actions, see OIR, *Viatical Criminal, Civil and Regulatory Actions*, http://www.floir.com/sections/landh/viaticals/ccr_actions.aspx (last visited Dec. 29, 2015) and 2013 OIR Report, *Appendix C: Florida Regulatory and Enforcement Actions Pertaining to Viatical Settlement Providers*.
[26] ss. 626.9914 and 626.99272 , F.S.
[27] ss. 626.611, 626.6115, 626.6215, and 626.621, F.S.
[28] s. 626.9541, F.S.
[29] OIR Agency Analysis, p. 2.

- *Insurable Interest Litigation by Life Insurers*: Insurers and investors have relied on two dueling statutes which are not in the Act.
    - As noted above, Florida expanded its insurable interest statute, s. 627.404, F.S., in 2008 to clarify when an insurable interest may be validly recognized for life insurance purposes. Life insurers have relied on this statute in filing suit to rescind the policies subsequently transferred in a STOLI transaction for a lack of insurable interest at the time of the policy.
    - However, another statute, s. 627.455, F.S., requires insurers to include an incontestability clause in their policies that bars a challenge to the policy after it has been in force for two years. Securities intermediaries (acting for the institutional investors) have relied on this statute as a kind of statute of limitations to seek dismissal of insurers' rescission cases, arguing that a tardy challenge is barred regardless whether the policy was made with an insurable interest at inception.
    - In separate cases, the U.S. District Court for the Southern District of Florida reached different interpretations on the interplay of these statutes.[30] These appeals were consolidated to the U.S. Court of Appeals for the Eleventh Circuit, which noted that there are no cases decided by Florida courts that specifically address whether a party can challenge an insurance policy as being void ab initio for lack of an insurable interest if the challenge is made after the two-year contestability period, and if so, whether the individual with the required insurable interest must procure the policy in good faith. As a result, the Eleventh Circuit certified questions to the Florida Supreme Court last year for a determination of Florida law on the conflict between these two statutes.[31]

However, current law does not specifically define STOLI, nor does it have a specific *regulatory* prohibition on STOLI or policies lacking an insurable interest at inception.

Effect of the Bill

The bill increases the OIR's regulatory authority over the Act in areas that the OIR believes are necessary to protect Florida consumers by clarifying fraudulent acts, prohibited practices, explicitly prohibiting STOLI transactions, requiring increased disclosures to viators, and increasing transparency of VSPs' operations. These provisions are largely based on a combination of model viatical settlement legislation from the NAIC and the NCOIL. The bill focuses on the "front-end" transaction by viatical settlement providers, not the "back-end" (securities regulation).

Definitions (Section 1)

As stated by the OIR, many activities described in this bill are already prohibited by current laws addressing fraud and illegal activities,[32] although, as noted above, many of these current laws may be ineffective or difficult to enforce. The bill addresses the historical prohibition on wagering on the lives of strangers by making "stranger-originated life insurance practices" and "fraudulent viatical acts" violations of the Act in section 3 of the bill, relating to the OIR's administrative authority over the Act.

Section 1 of the bill creates the following definitions in s. 626.9911, F.S.:

- *Business of viatical settlements*: an activity involved in offering, soliciting, negotiating, procuring, effectuating, purchasing, investing, monitoring, tracking, underwriting, selling, transferring, assigning, pledging, or hypotheticating of, or acquiring in other manner, an interest in a life insurance policy by means of a viatical settlement contract.
- *Fraudulent viatical settlement act* includes a comprehensive list, including preparing false or fraudulent material information or the concealment of material information related to a viatical settlement contract or life insurance policy; perpetuating or preventing the detection of a fraud;

[30] *Pruco Life Ins. V. Brasner*, 2011 WL 134056 (S.D. Fla. Jan. 7, 2011), and *Pruco Life Ins. Co. v. U.S. Bank*, 2013 WL 4496506 (S.D. Fla. Aug. 20, 2013).
[31] *Pruco Life Ins. Co. v. Wells Fargo Bank, N.A.*, 780 F.3d 1327 at 1336 (11th Cir. C.A. 2015). The appeal, currently pending at the Florida Supreme Court (Case No. SC15-382), is scheduled for oral argument on March 10, 2016, and will go back to the Eleventh Circuit for final disposition.
[32] OIR Agency Analysis, p. 2.

prohibitions on the use of trusts or in STOLI transactions; and the failure to disclose to the insurer when requested by the insurer that the prospective insured has undergone a life expectancy evaluation by any person other than the insurer or its authorized representatives in connection with the issuance of a policy.

- *Stranger-originated life insurance practice* is an act, practice, arrangement, or agreement to initiate a life insurance policy for the benefit of a third-party investor who, at the time of policy origination, has no insurable interest in the insured. This includes the creation of a trust or other entity that has the appearance of an insurable interest to initiate policies for investors.
    - Section 13 of the bill creates s. 626.99289, F.S., to make any contract, agreement, arrangement, or transaction that is entered into for the furtherance of a STOLI practice void and unenforceable.

Section 1 amends the following current definitions in s. 626.9911, F.S.:

- *Related form*: Related forms are any forms created by or on behalf of a VSP licensee, such as powers of attorney or a release of medical information form. Currently, the Act defines these to mean forms which a viator is required to sign. The bill adds insureds as persons required to sign these forms.
- *Viatical settlement contract:* Viatical settlement contracts are written agreements between a VSP or its related provider trust and the viator as the agreement to transfer orwnership or or change the beneficiary designation of a life insurance policy at a later date, and includes specified information. The bill amends this definition to include the sale of an interest in a trust or other entity if such entity was formed or used for the purpose of acquiring life insurance contracts that insure the life of a person residing in Florida. It also clarifies that a "viatical settlement contract" does not include accelerated death provisions in a life insurance policy or loan or advance from the issuer of the policy to the policyowner. This is consistent with the current definition of “viatical settlement provider,” which excludes life and health insurers that have lawfully issued a life insurance policy that provides accelerated benefits to terminally ill policyholders or certificateholders.
- *Viatical settlement provider:* The bill deletes the exclusion of, "other licensed lending institution," from the definition of a "viatical settlement provider," as it could be interpreted to be a premium finance company or some other entity with little or no regulatory oversight.

Annual Statement Filings (Section 2)

Section 2 of the bill amends s. 626.9913, F.S., to require a VSP to include additional information in their annual statement filings to the OIR. The bill codifies the language that is currently collected by the OIR to ensure VSPs consistently provide this information,[33] and adds a requirement for providers to submit total commissions or compensation, including across jurisdictions and on a yearly basis. Previously, the OIR sought to collect this information from VSPs through a proposed rule; however, the proposed rule was successfully challenged as an invalid exercise of legislative authority.[34] The bill authorizes the Financial Services Commission[35] to adopt rules to implement this section.
The bill increases the deposit requirement for VSPs to $250,000, from $100,000, which has not been increased since the Act’s adoption in 1996.[36] Additionally, the bill also deletes obsolete language pertaining to surety bond requirements and deposits.

Grounds for Administrative Action against VSPs (Section 3)

Section 3 of the bill amends s. 626.9914, F.S., to add “fraudulent viatical settlement act” to the list of grounds for suspension, revocation, denial or non-renewal of a VSP license. The bill also increases maximum administrative fines for non-willful violations of this section from $2,500 to $10,000 and willful

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[33] *Id.* at p. 2.

[34] *LISA v. Fin. Serv. Comm’n*, Case No. 09-0386RP (Fla. DOAH May 7, 2009); *partly affirmed* in *Office of Ins. Reg. v. LISA*, 31 So. 3d 953 (Fla. 1st DCA 2010).

[35] Pursuant to s. 20.121(3), F.S., the Financial Services Commission (the Governor and Cabinet) serves as the agency head for purposes of rulemaking and appoints the OIR’s Commissioner, who serves as the agency head for purposes of final agency action for all areas within the OIR’s regulatory authority

[36] The NAIC model viatical settlement act requires a $250,000 deposit.

violations from $10,000 to $25,000. These new caps match the maximum fines that OIR can assess against a VSP pursuant to s. 626.99272(2), F.S., for any violations of the entire Act, not just the enumerated grounds in s. 626.9914, F.S.

The bill also expands the prohibition in s. 626.9914(1)(i), F.S., on VSPs from employing any person who materially influences the licensee's conduct and who fails to meet the requirements of the Act, to apply to contractors as well.

Disclosures to Viators (Section 5)

Section 5 of the bill creates s. 626.99185, F.S., to establish new requirements for a VSP to disclose certain amounts paid to any broker along with a reconciliation of the difference between the gross offer and the net proceeds.[37] A viatical settlement provider, prior to executing a viatical contract, is required to obtain a signed and dated copy of this disclosure statement and any amended disclosure statement from the broker or viator. This new section also requires the VSP to maintain the statement for copying and inspection by the OIR pursuant to its examination authority in s. 626.9922(2), F.S.

Prohibited Practices & Conflicts of Interest (Section 8)

Section 8 of the bill creates s. 626.99273, F.S., titled "prohibited practices and conflicts of interest," which is based on the NAIC Model Act. This section prohibits a broker from sharing common control with or receiving funds from the VSP. It also requires VSPs to file their advertising and marketing materials to the OIR prior to entering into any viatical contracts. The advertising and marketing materials along with insurance agents, insurers, brokers and VSPs are prohibited from stating or implying that the life insurance is free for any period of time, which is currently an unfair insurance trade practice in s. 626.9541(1)(n), F.S. The bill's definition and prohibition of "fraudulent viatical settlement acts" also includes a violation of subsections (1) or (2), relating to conflicts of interest, which in turn are grounds for administrative action by the OIR. The bill also provides authority to the Financial Services Commission to adopt rules to implement this section.

Prohibited Practices – Criminal Penalties (Section 9)

Section 9 of the bill amends the criminal penalties statute of the Act, s. 626.99275, F.S., to criminalize:

- Knowingly entering into a viatical settlement contract before the application for or the issuance of a life insurance policy that is the subject of a viatical settlement contract, or during the five-year incontestability period of s. 626.9987, F.S., unless the viator provides a sworn affidavit and accompanying documentation in accordance with s. 626.9987, F.S.,
- Knowingly issuing, soliciting, marketing or promoting the purchase of a life insurance policy for the purposes of or emphasis on selling the policy, or
- Engaging in any fraudulent viatical settlement act.

Depending on the value of the insurance policy, these violations constitute a felony of the first, second, or third degrees.

Incontestability Period, Notice to Insurers, & Verification of Coverage (Sections 10 and 12)

Currently, the Act contains a contestability statute (s. 626.99287, F.S.), which provides that viatical settlements entered into within two years after the issuance of the insurance policy are generally void and unenforceable by either party, except in certain circumstances warranting a hardship exception, such as a viator's certification of a life-threatening illness or death of a viator's spouse. In these cases, the VSP submits the request to the insurer, who must "timely" respond. This provision does not preclude an insurer from contesting the validity of any policy on the grounds of fraud.

Section 12 of the bill amends s. 626.99287, F.S., to increase the incontestability period from 2 years to five years, thus requiring certain conditions be met within a 5-year period before applying for or entering into a life insurance policy that is the subject of a viatical settlement contract, and requires that the

[37] Currently, s. 626.99181, F.S., requires viatical settlement *brokers* to disclose their compensation to the viator.

viator provide a sworn affidavit and accompanying documentation certifying to the VSP that one or more of these conditions were met during the 5-year period. The bill also creates an exception to incontestability if, after more than 2 years from entering into a viatical settlement contract, at all times during the policy's issuance, the viator certifies that: (a) policy premiums have been funded exclusively with unencumbered assets; (b) no agreement with another party has been entered into to purchase the policy; and (c) the insured and the policy have not been evaluated for settlement.

Section 10 of the bill creates a notification to insurer statute (new s. 626.99276, F.S.), which clarifies the responsibilities of all parties involved in a viatical settlement and outlines the documents that must be submitted to the insurer as well as responsibilities of the insurer when dealing with the viatication of a policy. This section requires a viatical settlement provider to give notice to an insurer, including a copy of a sworn affidavit and documentation certifying that certain conditions have been met (as required by s. 626.99287, F.S., of the bill), if either the viator submits a request to the insurer for verification of coverage, or if the viatical settlement provider submits a request to transfer the policy or certificate to the provider. In response to a request for verification of coverage or transfer of policy, the section prohibits an insurer from requiring that the viator, insured, provider, or broker sign any disclosures or forms not specifically approved by the OIR for viatical settlement contracts. The section also requires that upon receipt of a request of a change of ownership or beneficiary, the insurer respond in writing within 30 days.

Anti-Fraud Plan Recordkeeping (Section 11)

Section 11 of the bill amends the anti-fraud statute (s. 626.99278, F.S.), to require licensed VSPs to maintain documentation of their compliance with their anti-fraud plan, documentation pertaining to material inconsistencies between medical records and insurance applications, and documentation of their reporting to the Division of Insurance Fraud. The documentation must be maintained in accordance with s. 626.9922, F.S., which requires licensees to maintain books and records for at least 3 years after the death of the insured and must be made available to the OIR or DFS for inspection during reasonable business hours.

Void and Unenforceable Contracts, Agreements, Arrangements, & Transactions (Section 13)

Section 13 of the bill creates s. 626.99289, F.S., to make any contract, agreement, arrangement, or transaction that is entered into for the furtherance of a “STOLI practice” (as defined in section 1 of the bill) void and unenforceable.

Cross-References (Sections 4, 6, and 7)

Sections 4, 6, and 7 of the bill amend ss. 626.99175, 626.9924, and 626.99245, F.S., respectively, to delete obsolete provisions and to correct cross-references.

B. SECTION DIRECTORY:

Section 1. Amends s. 626.9911, F.S., relating to definitions.
Section 2. Amends s. 626.9913, F.S., relating to viatical settlement provider license continuance; annual report; fees; deposit.
Section 3. Amends s. 626.9914, F.S., relating to suspension, revocation, denial, or nonrenewal of viatical settlement provider license; grounds; administrative fine.
Section 4. Amends s. 626.99175, F.S., relating to life expectancy providers; registration required; denial, suspension, revocation.
Section 5. Creates s. 626.99185, F.S., relating to disclosures to viator of disbursement.
Section 6. Amends s. 626.9924, F.S., relating to viatical settlement contracts; procedures; rescission.
Section 7. Amends s. 626.99245, F.S., relating to conflict of regulation of viaticals.
Section 8. Creates s. 626.99273, F.S., relating to prohibited practices and conflicts of interest.
Section 9. Amends s. 626.99275, F.S., relating to prohibited practices; penalties.
Section 10. Creates s. 626.99276, F.S., relating to notification to insurer required.
Section 11. Amends s. 626.99278, F.S., relating to viatical provider anti-fraud plan.
Section 12. Amends s. 626.99287, F.S., relating to contestability of viaticated policies.
Section 13. Creates s. 626.99289, F.S., relating to void and unenforceable contracts, agreements, arrangements, and transactions.
Section 14. Provides an effective date of July 1, 2016.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   Positive but indeterminate. The bill increases maximum administrative fines for non-willful violations of s. 626.9914, F.S., from $2,500 to $10,000, and willful violations of the same statute from $10,000 to $25,000.

2. Expenditures:

   Indeterminate. The bill requires the OIR to review additional forms and advertising materials. As there are currently no rules concerning viatical advertising, the OIR states that it is not possible to anticipate the volume of advertising materials the OIR may receive or the time OIR will have to expend reviewing such advertising.[38]

   In addition, the DFS noted that its investigations in viatical settlements primarily result from STOLI transactions, and that the bill's prohibition on STOLI transactions may significantly reduce their viatical-related investigative caseload. In addition, the DFS noted that the bill may be effective in reducing multiple loopholes and devices used to commit fraud in the viatical industry.[39]

   The bill may have an insignificant, yet indeterminate fiscal impact on state government expenditures due to the creation of a new felony offenses in s. 626.99275, F.S., for persons who knowingly enter into a viatical settlement contract in violation of the incontestability period and who do not meet the exceptions, for knowingly issuing or promoting the purchase of a life insurance policy for the purpose of or with an emphasis on selling the policy, or engaging in a fraudulent settlement act. The Criminal Justice Impact Conference has not yet met to determine the prison bed impact of the bill. However, the bill may have a negative prison bed impact on the Department of Corrections because the bill creates these new felony offenses.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   None.

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[38] OIR Agency Analysis, p. 4.
[39] Department of Financial Services, Agency Analysis of 2016 House Bill 445, p. 3 (Jan. 6, 2016).

2. Expenditures:

   None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Indeterminate. The bill increases regulatory requirements and administrative fines on viatical settlement providers. However, the bill may benefit consumers and life insurers by reducing the volume of lawsuits and fraudulent or speculative claims paid out by insurers, which could reduce overall premium costs.[40]

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

   Not applicable. The bill does not appear to affect county or municipal governments.

2. Other:

The bill is silent as to if or how it applies to policies issued or viaticated before the effective date of July 1, 2016. However, s. 624.21, F.S., provides that each amendment to the Insurance Code[41] (which includes the Act) shall be construed to operate prospectively, unless a contrary legislative intent is specified. This is consistent with the constitutional principle that unless the Legislature states otherwise, legislation is presumed only to operate prospectively, especially when retroactive application would impair existing rights. Even where the Legislature expressly states an intent for a statute to apply retroactively, courts will reject such an application if the statute impairs a vested right, creates a new obligation, or imposes a new penalty.[42]

State and federal appellate courts in California have held that the California 2009 anti-STOLI law (which, like this bill, established a statutory definition of STOLI and classified such transactions as fraudulent acts) does not apply retroactively to policies written or to beneficial interests transferred before the law took effect.[43] Similarly, the New York Court of Appeals held that New York law existing prior to anti-STOLI legislation (enacted in 2009) applied in a 2010 STOLI challenge.[44]

Under these principles (and regardless of how the Florida Supreme Court interprets the insurable interest and contestability statutes or how the Eleventh Circuit Court of Appeals adjudicates the parties' rights and obligations in *Pruco)*, it is unlikely a court would uphold retroactive application of subsequently enacted anti-STOLI legislation such as this bill.

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[40] *Id*.
[41] Section 624.01, F.S., provides that chs. 624-632, 634-636, 641-642, 648, and 651 constitute the Florida Insurance Code.
[42] *Menendez v. Progressive Exp. Ins. Co., Inc.*, 35 So.3d 873 (Fla. 2010).
[43] *Lincoln Life & Annuity Co. of N.Y. v. Berck*, 2011 WL 1878855 (Cal. Ct. App. 2011), *review denied* Aug. 31, 2011; *Wells Fargo Bank, N.A. v. American Nat. Ins. Co.*, 493 Fed.Appx. 838 (9th Cir. 2012).
[44] *Kramer v. Phoenix Life Ins. Co.*, 15 N.Y. 3d. 539 at 549, n. 5 (2010).

B. RULE-MAKING AUTHORITY:

The bill provides rulemaking authority to the Financial Services Commission regarding annual reporting, advertising and marketing, and conflicts of interest requirements (sections 2 and 8 of the bill).

C. DRAFTING ISSUES OR OTHER COMMENTS:

- DFS noted that section 5 of the bill could be clarified as to the viatical settlement broker's responsibility in securing disclosure statements and providing any mandated copies to the viator.[45]
- The examination authority statute, s. 626.9922, F.S., which is not amended by the bill, refers to certain books and records that must be maintained and made available to the OIR. Specifically, subsection (2) of the statute requires VSP licensees to maintain books, records, and so forth, "relating to all transactions of viatical settlement contracts, life expectancies, or viatical settlement purchase agreements made before July 1, 2005" for three years after the insured's death. This provision could be clarified so as not to limit interpretation and application of this statute to only pre-2005 agreements and contracts.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

On January 13, 2016, the Insurance & Banking Subcommittee adopted one amendment and repoted the bill favorably as a committee substitute. The amendment:

- Amends the definition of "stranger-originated life insurance practice" to include the creation of a *non-trust entity* that has the appearance of an insurable interest to initiate policies for investor, which violates insurable interest laws and the prohibition against wagering on human life.
- Clarifies viatical settlement providers' new annual reporting requirements in s. 626.9913, F.S., so that:
  - Certain policy data must be reported for *each year of the most recent 5 years*, and not one aggregate filing for that 5 year period, and
  - Total proceeds or compensation paid to policyowners should be reported *for the most recent calendar year*.
- Increases the minimum deposit requirement in s. 626.9913(3), F.S., from $100,000 to $250,000;
- Expands the prohibition in s.626.9914(1)(i), F.S., on viatical settlement providers from employing any person who materially influences the licensee's conduct and who fails to meet the requirements of the Act, to apply to contractors as well.
- Replaces the undefined term life insurance "producers" in new s. 626.99273, F.S., with the term "agent," which is defined in s. 626.015(2), F.S., as including producers. As a result, the bill prohibits agents (and other entities) from representing to applicants or policyholders that insurance is free or without cost for any period of time.
- Restores the contestability statute, s. 626.99287, F.S., and amends it to include the new 5-year incontestability period and exceptions in the original bill's s. 626.99275, F.S. (prohibited practices; penalties), clarifies an existing exception, and
- Makes conforming changes to cross-references.

This analysis is drafted to the committee substitute as passed by the Insurance & Banking Subcommittee.

[45] DFS Agency Analysis, p. 3.