

Testimony of the
National Association of Insurance Commissioners

Before the
Subcommittee on Capital Markets, Insurance, and
Government Sponsored Enterprises

Committee on Financial Services
United States House of Representatives

Regarding:
Regulating Viatical Settlement Transactions and Promoting
Information Sharing Among State and Federal
Financial Regulators

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Testimony of Tom Gallagher, Chief Financial Officer Florida Department of Financial Services

Introduction

My name is Tom Gallagher. I am the Chief Financial Officer in charge of the Florida Department of Financial Services, which among other responsibilities oversees the regulation of the business of insurance. Florida has long been an active leader in protecting consumers from fraud, particularly the elderly who are targeted by unscrupulous peddlers of insurance products that have little or no use. Our experience and success in Florida can serve as a useful example to the Financial Services Committee of how states are actively working to guard against insurance fraud in the marketplace.

As Florida has been a primary participant on the Viatical Settlements Working Group of the National Association of Insurance Commissioners (NAIC), I am also pleased to be here on behalf of the NAIC to discuss its activities to improve state supervision of viatical settlement transactions and gain equal access to federal criminal history and regulatory information databases for state insurance regulators.

The Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises asked that my testimony today focus on two basic issues:

1. The importance to Florida of using its viatical settlement law, which is based in part upon the NAIC model act, to prevent and punish fraud; and
2. The need for establishing an anti-fraud information network that grants state insurance regulators equal access to criminal enforcement history databases maintained by the FBI and the National Association of Securities Dealers (NASD).

NAIC Efforts on Regulating Viatical Settlement Transactions

In 1989, the first viatical company was formed to buy insurance policies of terminally ill individuals for a percentage of the face value. By 1992, when it became clear that viatical companies would continue to flourish, the NAIC determined that a model law was needed to provide regulation of viatical companies in order to protect consumers who sold their policies at a time when they were not in a good bargaining position.

The NAIC began its review of regulating viatical transactions by asking two basic questions: (1) What protections should be afforded life insurance policyholders who sell their policy to a viatical company or broker that will pay the premiums and receive the proceeds? (2) What should state insurance regulators do to protect investors?

The initial model law developed by NAIC requires companies and brokers to obtain a license before entering into viatical settlement agreements. Under this model, an insurance commissioner has authority to refuse to grant or to revoke a license if the licensee is found guilty of fraud or makes unreasonable payments. The commissioner also has authority to examine viatical settlement providers and approve their contracts. The most important part of the model law is a set of protections for insurance consumers, including disclosure, payment of the proceeds into an escrow account, and confidentiality of medical information.

The current NAIC model, updated in March 2001, recognizes the viatical settlement marketplace is changing, which means state laws must also change. This version broadens the definition of viatical settlement to include any sale of a life insurance policy for less than its face value, whereas the earlier model limited the sales to policies where the insured was terminally or chronically ill. The current model includes valuable new protections against fraud and allows states the option of addressing the security side of

the transaction (sales to investors) in the insurance department if the state legislature deems it to be appropriate.

Twelve states that have already implemented the new version include Alaska, Florida, Iowa, Kansas, Nebraska, Nevada, North Carolina, North Dakota, Ohio, Pennsylvania, Utah, and Virginia. A number of other states have broadened their definition to provide protection to more consumers, and several have the newer model pending.

Florida's Experience with Fighting Viatical Fraud

The primary defense against viatical settlement fraud is to have a strong law that state regulators can use to identify fraud artists and prevent or punish their wrongful activities. Florida has such a tough law on the books, and we aggressively enforce its provisions. We believe the results demonstrate clearly that fighting viatical fraud is a worthwhile use of regulatory powers to protect consumers in our state and elsewhere.

Florida insurance regulators had substantial input in developing the NAIC model act. We believe it is a top-notch model for adoption by all states. As can be seen by the comparison chart attached as Appendix A to my testimony, the state of Florida has fashioned its own viatical settlements law to closely follow the NAIC model act.

The Florida Legislature passed The Florida Viatical Settlement Act in 1996. Its initial purpose was to protect an insured individual, defined in the Act as a "viator", diagnosed with a chronic or terminal illness who was willing to sell the death benefits of his or her life insurance policy for less than the face amount of the policy. This definition was later expanded by deleting the "diagnosed with a chronic or terminal illness" qualification which resulted in the Act covering anyone willing to sell the death benefits of his or her life insurance policy for less than the face amount of the policy. Since enactment, the Department of Financial Services, formerly known as the Department of Insurance, has received less than a dozen written complaints from viators.

Accordingly, the original intent of the Viatical Settlement Act in protecting the viator has been successful. The Act was not originally intended to protect investors investing in such policies. However, subsequent to enactment, the Department of Financial Services received hundreds of complaints from investors, mostly elderly, who had lost millions of dollars in viatical related scams. As a result, since 1996 we have enacted a number of amendments to the Florida Viatical Settlement Act to curtail investor abuses. Many of these amendments to the original act can also be found in the NAIC model act.

Viatical Enforcement Results in Florida as of May 5, 2003

In Florida, we believe the relevant statistics support our dedication to having a strong law that is matched by aggressive enforcement. Although strong legislation cannot in all cases defeat the fraudulent acts of someone bent on committing a crime, it can arm regulators with tools and sanctions needed to investigate and prosecute violators.

Looking first at the total number of 35 viatical provider applications in Florida since October 1996, it is easy to see that 21 of the 35 failed to gain approval. Without sound regulatory scrutiny as provided under our Florida law, many or all of these applicants could be operating in the state of Florida:

- Applications Withdrawn 17
- Applications Denied: 4
- Licenses Revoked: 3
- Licenses Surrendered: 3 (one filed for bankruptcy)
- Currently Licensed: 8

The importance of fighting fraud is shown by the following statistics which show that viatical settlements are big business for both the providers and the viators. Licensed viatical providers and their investors in Florida have reported the following for the period from 1996 through 2002:

- 14,017 life insurance policies purchased from viators, having a face value of \$2,970,743,069, for which viators were paid \$953,758,851.
- The average amount invested by each investor was \$44,733.
- Average age of an investor was 70.5
- Department of Financial Services Regulatory Actions in Florida since October 1996 is 21.

Broken down as follows:

Providers = 8

Brokers = 2

Agents = 3

Officers/employees = 5

Unlicensed entities = 3

Viatical Criminal Cases Affecting Florida

These cases encompass indictments against 38 individuals:

- Provider (Sweeney/Future First)
- Provider (Stelk, Keaveney, Anderson, Sussman/Future First)
- Provider (Sutherland, Keller and Drach of Kelco)
- Unlicensed Provider (Justus Viatical)
- Unlicensed Provider (Financial Federated Title and Trust, Asset Security Corporation)
- Broker (Life Benefit Services)
- Medical doctor providing fraudulent life expectancies (Dr. Clark C. Mitchell)
- 11 viators for fraudulent acts

The Department of Financial Services is working closely with the Federal Viatical Task Force involving the FBI and U.S. Postal Inspection Service, as well as having ongoing

partnerships with the SEC and other state law enforcement agencies involved in viatical investigations.

Highlights of Enforcement Activities:

- The Division has executed 9 search warrants on viatical related companies.
- The Division has seized over 1000 files representing in excess of \$76,000,000 of suspected fraudulently obtained “clean-sheeted” life insurance policies.

Potential criminal violations commonly reviewed are theft, misrepresentation, investor fraud, securities/investment issues.

Estimated Viatical Settlement Provider Losses to Investors

- Justus Viatical Group – Juno Beach, FL – \$2,000,000
Never licensed in Florida. Criminal charges were filed.
- American Benefit Services/Financial Federated Title & Trust – Lake Worth, FL – \$117,000,000
Never licensed in Florida. However, revoked the viatical broker license of American Benefits Services, as well as the life agent license of its principal Raphael Levy, who in association with Financial Federated Title & Trust, sold millions of dollars worth of interests in non-existent life insurance policies to citizens across the nation, (the principals of both companies, and the trustee of the affiliated trust, by the way, are serving lengthy prison sentences).
- Future First Financial Group, Inc. – Ponte Vedra Beach, FL – \$203,000,000
License was revoked and criminal charges filed. Revoked the viatical provider license of Future First Financial Group for knowingly selling interests in fraudulently procured policies to investors, and subsequently placed the entire company into a court-appointed conservatorship. Further, the Fraud Division, working in conjunction with the Florida Attorney General’s Statewide Prosecutor

Office, has brought about the arrest and by both indictment and information and the formal bringing of criminal charges against the former vice president and president of Future First. The former president was just arrested and now resides in a county jail under \$10 million dollar bond.

- Accelerated Benefits Corporation – Orlando, FL – \$ 114,500,000
Revoked the viatical settlement provider license of Accelerated Benefits Corporation for knowingly selling interests in fraudulently procured policies to investors.
- William Page & Associates
Via consent order, administratively disciplined the viatical settlement provider license of William Page and Associates for charging investors post-sale monies not authorized by their viatical settlement purchase contracts. Page agreed, among other things, to refund all monies in question, pay a substantial administrative fine, and submit to a two-year probationary period during which it must make quarterly reports to the Department of Financial Services.

NAIC Supports Establishing a National Anti-fraud Network

On March 6, 2001, then NAIC Vice President Terri Vaughan testified before the Financial Services Committee in support of establishing a national anti-fraud network among federal and state financial regulatory agencies. The NAIC's support for creating an effective network that draws on current resources and opens doors for equal participation by state insurance regulators remains the same.

The NAIC presently has the technical infrastructure in place to share regulatory database information. Because NAIC is the central database manager and link to individual state insurance department computer systems, it has developed a modern online information exchange system that should have no difficulty in expanding to include federal agencies. Likewise, NAIC is fully capable of receiving and handling both public and confidential

regulatory information. In fact, the NAIC may be able to offer guidance in setting up a workable system to agencies having less experience in this area.

The NAIC believes a national multi-agency information exchange system should be structured as follows –

- Create an anti-fraud network based upon information sharing agreements among functional financial regulators and law enforcement agencies.
- Establish a central database authority to set technical standards for sharing regulatory and law enforcement information.
- A multi-agency information sharing system should link existing databases rather than create new ones. Each regulator has a large investment in its own systems and databases, including training and integration. Functional regulators need to work within their own unique system interface, but will require access to data stored on outside databases in order to be effective.
- Finally, all participants in a multi-agency system should be given legal immunity for good faith reporting of regulatory information and operation of the system.

State Insurance Regulators Need Immediate Access to FBI's Fingerprint Database

While NAIC supports Congressional efforts to create a broad anti-fraud information sharing network, we repeat our request that you fix one glaring weakness in the system immediately. Right now, state insurance regulators are the only functional regulators who do not have access to the Fingerprint Identification Record System (FIRS) operated by the FBI. Congress should close this gaping loophole before doing anything else.

Permitting states to run national fingerprint background checks on insurance producers and company personnel is the best way to weed out known wrongdoers before they get a chance to commit insurance fraud. It is also critical if Congress expects the states to establish a national agent licensing system, as mandated by the NARAB section of the Gramm-Leach-Bliley Act (GLBA). In addition, the federal law punishing insurance fraud (18 USC 1033) establishes an affirmative duty for state insurance regulators to check the criminal history of persons re-entering the insurance industry, yet there is presently no uniform access method for us to conduct such checks with the FBI's fingerprint database.

The General Accounting Office (GAO) specifically recommended that state insurance departments be granted access to Federal criminal history data as part of its report on Martin Frankel's activities (Insurance Regulation: Scandal Highlights Need for Strengthened Regulatory Oversight; GAO/GGD-00-198, September 2000, page 50). The GAO has also found that several viatical fraud artists had previous criminal convictions. Since viatical settlement transactions are a crossover insurance and securities product, the NAIC believes it is just plain common sense that insurance regulators should have access to the viatical agent's past disciplinary and criminal records in order to protect consumers.

The fastest way to grant state insurance departments access to the FBI's fingerprint database is by federal statute that simply gives insurance regulators the same access to FBI fingerprint files that banks, bank regulators, and the American Banking Association currently possess. We ask that you act quickly to put us on a level playing field with federal functional regulators.

State Insurance Regulators Need Access to NASD's Enforcement Database

State regulators also need Congress to help us gain access to the national securities enforcement database maintained by the National Association of Securities Dealers (NASD). In return, the NAIC is willing to share with NASD the extensive database information NAIC maintains on insurance agents and companies. The GAO specifically

recommended that securities and insurance regulators exchange regulatory information in its Martin Frankel report (pp. 49-50). We believe closer coordination between securities and insurance regulators is becoming even more important as the products and sales of these products become further intertwined.

Regulatory Confidentiality Must Be Preserved for Information Sharing to Work

Congress should act quickly to guarantee the confidentiality of regulatory information exchanges between state insurance departments and federal agencies, especially in fighting fraudulent activities that have not been fully proven. The system of functional regulation set forth in GLBA requires that regulators communicate freely on all matters of mutual interest. They cannot do so if they cannot maintain confidentiality for regulatory information.

During the NAIC's efforts to negotiate regulatory cooperation agreements with the Federal Reserve Board, OCC, OTS, and FDIC, one of the biggest concerns has been the protection of sensitive information when it passes from one functional regulator to another. Federal agencies are wary of state freedom of information laws, while states are equally concerned about the level of federal safeguards. In the end, because we could not resolve the confidentiality questions in a manner that could apply to all states, the NAIC's model agreement anticipates that some states will alter it to fit their particular laws. As a result, we are unlikely to achieve a uniform nationwide level of confidentiality on information exchanges without additional action by Congress.

NAIC recommends that Congress act quickly to enact a federal law that protects the confidentiality of regulatory information exchanges.

Conclusion

State insurance regulators and the NAIC fully support Congressional efforts to fight viatical settlement fraud and create a nationwide anti-fraud network of information

sharing among regulators. The NAIC has taken the lead in developing a viatical settlements model act for states to adopt, and many of them have already done so. Florida is a leader in using its viatical settlement law based upon the NAIC model to aggressively fight fraud in our state. We welcome efforts to extend the benefits of the NAIC model to other states.

With regard to information networking, the NAIC is ready to share the information in its own regulatory databases in exchange for receiving the information held by securities and banking regulators. The NAIC also possesses a high level of technical expertise and resources to implement a national database system quickly if it is built upon networking existing facilities instead of building new ones.

The most urgent need, in the opinion of NAIC, is for Congress to open the doors to the FBI fingerprint and NASD enforcement databases, as well as to protect the confidentiality of regulatory information. These critical tools should not be left waiting while Congress determines how other elements of a national anti-fraud information program should be implemented.

Thank you for providing me this opportunity to assist Congress on behalf of Florida insurance consumers and members of the NAIC.

APPENDIX A

Summary of Florida Statutes

- Defines terminology.
- Requires licensing of providers, brokers, and sales agents.
- Licensing requirements include:
 - Fingerprints
 - Background checks
 - Fee
 - Collateral deposit
- Required use of escrow & trust agents.
- Annual reporting requirements.
- Regulatory penalties:
 - Revocation
 - Suspension
 - Denial
 - Fines
 - Non-renewal
- Criminal penalties:
 - Felony charges based on face value of life insurance policy;
 - 3rd degree = <\$20,000
 - 2nd degree = >\$20,000 but <\$100,000
 - 1st degree = >\$100,000
- Forms and related documents must be filed with and approved by the Office of Insurance Regulation, within the Department of Financial Services, prior to their use.
- Record retention requirements for 3 years past the insureds death.
- Required disclosures to viators & purchasers.
- Unfair trade practice; Unlawful acts:
 - Transacting in fraudulently obtained policies.
 - Employing a scheme or artifice to defraud.
 - Untrue statements of a material fact.
 - Omission to state a material fact.
 - Advertising misrepresentations.
- Required anti-fraud plan.
- Consumer rights to civil action.

Summary of NAIC Model Act

- Defines terminology.
- Requires licensing of providers, brokers, and investment agents.
- Licensing requirements include:
 - Background checks
 - Fee
- Annual reporting requirements.
- Regulatory penalties:
 - Revocation
 - Suspension
 - Denial
 - Fines
 - Non-renewal
- Criminal penalties:
- If viatical settlement contract values are:
 - > \$35,000 = imprisonment for up to 20 years or payment of fine up to \$100,000 or both.
 - >\$2,500 but < \$35,000 = imprisonment up to 10 years or payment of fine up to \$20,000 or both.
 - >\$500 but < \$2,500 = imprisonment up to 5 years or payment of fine up to \$10,000 or both.
 - <\$500 = imprisonment up to 1 one or payment of fine up to \$3000 or both.
- Forms and related documents must be filed with and approved by the commissioner of each state prior to their use.
- Record retention required for 5 years pass the date of contract transaction.
- Required disclosures to viators & purchasers.
- Unfair trade practice; Unlawful acts:
 - Reference made to each state.
 - Fraud prevention & control:
 - Noninterference of investigation
 - Use of convicted felons prohibited.
 - Fraud warning requirement.
 - Required anti-fraud plan.
 - Mandatory reporting of fraudulent acts.
 - Consumer rights to civil action.

