HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: PCS for HB 1205 Viatical Settlement Contracts
SPONSOR(S): Insurance & Banking Subcommittee
TIED BILLS: **IDEN./SIM. BILLS:**

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
Orig. Comm.: Insurance & Banking Subcommittee		Hinshelwood	Luczynski

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 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 ("the Act").

In the early 2000s, a related product known as "stranger-originated life insurance" (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.

There has been ongoing litigation regarding the interplay between the insurable interest requirement for obtaining life insurance and the two-year window within which a party may challenge a policy after its inception. In September 2016, the Florida Supreme Court determined, based on a plain reading of the statutes, that a party could not challenge the validity of a life insurance policy after the two-year contestability period, even on the basis that the policy was created through a STOLI scheme.

In response to that case, the bill provides that, notwithstanding the two-year limitation on contestability of a life insurance policy, a contract or transaction entered into for the furtherance of a STOLI practice is void and unenforceable, and a life insurer may contest a life insurance policy if the policy was obtained by a STOLI practice.

Additionally, the bill makes the following amendments to the Act:

- Defines what constitutes a "STOLI practice" as well as a "fraudulent viatical settlement act" and provides criminal penalties for engaging in either practice;
- Expands the contestability period for viaticated life insurance contracts from 2 years to 5 years; and
- Amends certain exceptions to the general rule that a life insurance policy cannot be viaticated during such contestability period.

The bill has no fiscal impact on the state, local governments, or the private sector.

The bill takes effect immediately upon becoming a law.

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 which was lost by the death of the insured.[1] Life insurance dates back 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 exists 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 visited Mar. 22, 2017).

[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] *Warnock*, 104 U.S. at 779; *Connecticut Mut. Life Ins. Co.*, 94 U.S. at 460; *Aetna Life Ins. Co. v. France*, 94 U.S. 561 (1876) and *Grigsby v. Russell*, 222 U.S. 149 (1911).

[5] 2009 OIR Report, *supra* note 2, at 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 is 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 or 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 risking their savings in what was represented as a safe investment and was 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

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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 (last visited Mar. 22, 2017).
[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 Mar. 23, 2017).
[11] Ch. 96-336, Laws of Fla.

(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 penalties. The Act also provides the OIR with examination and enforcement authority over VSPs and brokers; provides review and approval authority over the viatical settlement contracts and forms; provides rulemaking authority; and makes a violation of the Act an unfair trade practice under the Insurance Code.[13] The Act does not authorize the OIR to regulate the rate or amount paid as consideration for a viatical settlement contract.[14]

Since its inception, the Act has been substantively amended seven times to enhance consumer protections and to address changes in the viatical settlement industry.[15] 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.[16] 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.[17]

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.[18]
- 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.[19] 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.[20] 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.[21]

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[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.

[13] Section 624.01, F.S., provides that chs. 624-632, 634-636, 641-642, 648, and 651 constitute the Florida Insurance Code.

[14] s. 626.9926, F.S.

[15] 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.

[16] Ch. 2005-237, Laws of Fla.

[17] ss. 626.9911(9) and 626.9916, F.S.

[18] 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.

[19] 2013 OIR Report, *supra* note 8, at 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.

[20] Ch. 2013-40, §6, Laws of Fla. (2013 General Appropriations Act, p. 316).

[21] 2013 OIR Report, *supra* note 8, at 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 is a scheme in which 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.[22] A STOLI is 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.[23]

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:[24]

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

[22] AALU, NAIFA, and ACLI, *STOLI: The Problem and the Appropriate State Response*, p. 4.

[23] UNIFORM LAW COMMISSION, *Insurable Interest Amendment to the Uniform Trust Code Summary*, at http://uniformlaws.org/ActSummary.aspx?title=Insurable%20Interest%20Amendment%20to%20the%20Uniform%20Trust%20Code (last visited Mar. 22, 2017).

[24] Office of Insurance Regulation, Agency Analysis of 2017 House Bill 1205 ("OIR Agency Analysis"), p. 5 (Mar. 12, 2017). 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.[25]
- 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.

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 as well as criminal and regulatory enforcement actions, both nationally and in Florida.[26]

Below are several of the grounds for litigation, criminal, or regulatory actions related to 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.[27]
- *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.[28]
- *Unfair Insurance Trade Practices Act*: Part IX of ch. 626, F.S., contains a number of unfair insurance trade practices. In particular, s. 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"[29] and "churning"[30] are first-degree misdemeanors, while willfully submitting

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[25] *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.

[26] 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 Mar. 22, 2017) and 2013 OIR Report, *supra* note 8, at *Appendix C: Florida Regulatory and Enforcement Actions Pertaining to Viatical Settlement Providers*.

[27] ss. 626.9914 and 626.99272, F.S.

[28] ss. 626.611, 626.6115, 626.6215, and 626.621, F.S.

[29] As defined in s. 626.9541(1)(l), F.S., "twisting" means "knowingly making any misleading representations or incomplete or fraudulent comparisons or fraudulent material omissions of or with respect to any insurance policies or insurers for the purpose of inducing, or tending to induce, any person to lapse, forfeit, surrender, terminate, retain, pledge, assign, borrow on, or convert any insurance policy or to take out a policy of insurance in another insurer."

false signatures on an application is a third-degree felony.[31] While VSPs are subject to s. 626.9541, F.S., 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, thereby making it difficult to apply the statute to secondary sales of life insurance policies.[32]

- *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.[33] 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 for a determination of Florida law on the conflict between these two statutes.[34]
  - In September 2016, the Florida Supreme Court considered the Eleventh Circuit's certified questions and concluded that "[b]ecause the STOLI policies like the . . . policies at issue have the insurable interest required by section 627.404(1) at their inception, they become incontestable two years after their issuance under the plain language of section 627.455."[35] The Florida Supreme Court rephrased the certified question and answered the following in the negative: "Can a party challenge the validity of a life insurance policy after the two-year contestability period established by section 627.455

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[30] "Churning" by an insurer or an agent is an unfair method of competition and an unfair or deceptive act or practice. As defined in s. 626.9541(1)(aa), F.S., "churning" is:

> the practice whereby policy values in an existing life insurance policy or annuity contract, including, but not limited to, cash, loan values, or dividend values, and in any riders to that policy or contract, are directly or indirectly used to purchase another insurance policy or annuity contract with that same insurer for the purpose of earning additional premiums, fees, commissions, or other compensation:
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> a. Without an objectively reasonable basis for believing that the replacement or extraction will result in an actual and demonstrable benefit to the policyholder;
> b. In a fashion that is fraudulent, deceptive, or otherwise misleading or that involves a deceptive omission;
> c. When the applicant is not informed that the policy values including cash values, dividends, and other assets of the existing policy or contract will be reduced, forfeited, or used in the purchase of the replacing or additional policy or contract, if this is the case; or
> d. Without informing the applicant that the replacing or additional policy or contract will not be a paid-up policy or that additional premiums will be due, if this is the case.

[31] s. 626.9541, F.S.

[32] OIR Agency Analysis, *supra* note 24, at 2.

[33] *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).

[34] *Pruco Life Ins. Co. v. Wells Fargo Bank, N.A.*, 780 F.3d 1327 at 1336 (11th Cir. C.A. 2015).

[35] *Wells Fargo Bank, N.A. v Pruco Life Ins. Co.*, 200 So. 3d 1202, 1206 (Fla. 2016). The appeal will go back to the Eleventh Circuit for final disposition.

because of its creation through a STOLI scheme?"[36] Answering in the affirmative would essentially create a STOLI-policy exception to the two-year contestability period in s. 627.455, F.S. The Florida Supreme Court noted that, "[w]hile such an exception might be wise public policy, that decision is for the Florida Legislature, not this Court."[37]

In summary, current law does not specifically define STOLI and does not specifically prohibit practices or arrangements designed to initiate a life insurance policy for the benefit of a third-party who lacks an insurable interest in the insured at the policy's inception.

Effect of the Bill

The bill defines fraudulent viatical settlement acts, defines STOLI, and adds prohibited practices. The bill also amends provisions relating to the contestability and enforceability of viaticated policies and STOLI policies. These provisions are largely based on a combination of model viatical settlement legislation from the NAIC and the NCOIL.

Definitions (Section 1)

The bill creates the following definitions in s. 626.9911, F.S.:

- *Fraudulent viatical settlement act* includes a comprehensive list of acts or omissions of an intentional nature, such as the following:
    - Presenting false or concealed material information concerning a fact material to such things as an application for, or the underwriting of, a viatical settlement contract or life insurance policy;
    - Employing a plan, financial structure, or artifice relating to viaticated policies for the purpose of perpetrating fraud;
    - Engaging in a STOLI practice;
    - Failing to disclose, upon request 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 the life insurance policy;
    - Perpetuating a fraud or preventing the detection of a fraud by doing such acts as altering or destroying the assets or records of a licensee;
    - Misappropriation of funds of a viatical settlement provider, insurer, insured, viator, insurance policy owner, or other person engaged in the business of viatical settlements or insurance;
    - Entering into or brokering a viatical settlement contract, the subject of which is a life insurance policy that was obtained based on information that was falsified or concealed for the purpose of defrauding the policy's issuer, viatical settlement provider, or viator;
    - Facilitating the viator's change of residency state to avoid the provisions of the Act;
    - Facilitating the creation of a trust with a situs outside this state for the purpose of owning a life insurance policy covering a Florida resident to avoid the provisions of the Act;
    - Facilitating the transfer of ownership of an insurance policy covering a Florida resident to a trust with a situs outside this state to avoid the provisions of the Act;
    - Obtaining a loan that is secured directly or indirectly by an interest in a life insurance policy;
    - Attempting to commit, assisting, aiding, or abetting in the commission of, or conspiring to commit, an act or omission specified in this subsection.
- *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. STOLI practices include, but are not limited to:

[36] *Id.* at 1206-07.
[37] *Id.* at 1203.

- The purchase of a life insurance policy with resources or guarantees from or through a person who, at the time of such policy's inception, could not lawfully initiate the policy and the execution of a verbal or written arrangement or agreement to directly or indirectly transfer the ownership of such policy or policy benefits to a third party; and
- The creation of a trust or other entity that has the appearance of an insurable interest in order to initiate policies for investors, in violation of insurable interest laws and the prohibition against wagering on life.

Cross-References (Sections 2 and 3)

Sections 2 and 3 of the bill amend ss. 626.9924 and 626.99245, F.S., respectively, to conform cross-references.

Prohibited Practices & Criminal Penalties (Section 4)

The bill adds the following to the list of prohibited practices under the Act:

- Knowingly entering into a viatical settlement contract before the application for or issuance of a life insurance policy that is the subject of a viatical settlement contract, or within five years after the policy issuance date, unless the viator provides a sworn affidavit and accompanying documentation certifying that certain conditions were met;
- Engaging in a fraudulent viatical settlement act;
- Knowingly issuing, soliciting, marketing, or otherwise promoting the purchase of a life insurance policy for the purpose of or with an emphasis on selling the policy to a third party; and
- Engaging in a stranger-originated life insurance policy practice.

The prohibited practices are accompanied by criminal penalties, which are not changed by the bill. The severity of the penalties varies depending on the value of the insurance policy. If the value of the insurance policy is valued at:

- Less than $20,000, then the violation is a third-degree felony;
- $20,000 or more but less than $100,000, then the violation is a second-degree felony;
- $100,000 or more, then the violation is a first-degree felony.

Contestability of Viaticated Policies (Section 5)

The bill amends s. 626.99287, F.S., which contains the contestability requirements for viaticated life insurance contracts. Generally, a life insurance policy cannot be viaticated during the contestability period, and such viatical settlement contracts are void and unenforceable. The bill expands the contestability period for viaticated life insurance contracts from 2 years to 5 years. A viatical settlement contract may be entered into during the contestability period, however, under various exemptions, one of which is the execution by the viator of a sworn affidavit certifying that certain conditions such as the diagnosis of a life threatening illness or the death of a spouse have occurred. The bill provides that in order for any of the exceptions to be claimed, the viator must provide a sworn affidavit that one of the exceptions applies.

The bill also revises two of the existing exceptions:

- The exception for a life insurance policy issued upon the owner's exercise of conversion rights arising out of a group or term policy is limited by the bill to instances when the total time covered under the prior policy is at least 60 months. Conversion occurs when the insured converts life insurance under a group policy to an individual policy, often because the insured no longer qualifies for the group policy.
- The exception for illness is amended to require the viator to be "terminally or chronically ill." Currently this exception requires a diagnosis of an illness or condition that is catastrophic, life threatening, or requires a course of treatment of at least 3 years or home health care.

The bill retains the 2-year contestability period if three conditions are met:

- Policy premiums have been funded exclusively with unencumbered assets, including an interest in the life insurance policy being financed only to the extent of its net cash surrender value, provided by, or fully recourse liability incurred by, the insured;
- There is no agreement or understanding with any other person to guarantee any such liability or to purchase, or stand ready to purchase, the policy, including through an assumption or forgiveness of the loan; and
- Neither the insured nor the policy has been evaluated for settlement.

Void and Unenforceable Contracts, Agreements, Arrangements, & Transactions (Section 6)

The bill creates s. 626.99289, F.S., to provide that, notwithstanding the two-year contestability period established by s. 627.455, F.S., any contract, agreement, arrangement, or transaction entered into for the furtherance or aid of a STOLI practice is void and unenforceable.

Contestability of Life Insurance Policies Obtained by a STOLI Practice (Section 7)

The bill creates s. 626.99290, F.S., to provide that, notwithstanding the two-year contestability period established by s. 627.455, F.S., a life insurer may contest a life insurance policy if the policy was obtained by a STOLI practice.

In response to the *Pruco* case from the Florida Supreme Court,[38] the creation of ss. 626.99289 and 626.99290, F.S., are intended to create a STOLI-policy exception to the two-year contestability period in s. 627.455, F.S.

B. SECTION DIRECTORY:

Section 1. Amends s. 626.9911, F.S., relating to definitions.

Section 2. Amends s. 626.9924, F.S., relating to viatical settlement contracts; procedures; rescission.

Section 3. Amends s. 626.99245, F.S., relating to conflict of regulation of viaticals.

Section 4. Amends s. 626.99275, F.S., relating to prohibited practices; penalties.

Section 5. Amends s. 626.99287, F.S., relating to contestability of viaticated policies.

Section 6. Creates s. 626.99289, F.S., relating to void and unenforceable contracts, agreements, arrangements, and transactions.

Section 7. Creates s. 626.99290, F.S., relating to contestability of life insurance policies.

Section 8. Provides that the act will take effect upon becoming a law.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   None.

2. Expenditures:

[38] *Pruco*, 200 So. 3d at 1203 & 1206-07.

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

The bill does not appear to have an impact on local government revenues.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

None.

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not applicable. This 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 the bill (upon the act becoming a law). However, s. 624.21, F.S., provides that each amendment to the Insurance Code[39] (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.[40]

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.[41] 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.[42]

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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[39] Section 624.01, F.S., provides that chs. 624-632, 634-636, 641-642, 648, and 651 constitute the Florida Insurance Code.
[40] *Menendez v. Progressive Exp. Ins. Co., Inc.*, 35 So.3d 873 (Fla. 2010).
[41] *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).
[42] *Kramer v. Phoenix Life Ins. Co.*, 15 N.Y. 3d. 539 at 549, n. 5 (2010).

B. RULE-MAKING AUTHORITY:

The bill does not appear to create a need for rulemaking or rulemaking authority.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES