# DELAWARE DEPARTMENT OF INSURANCE

## SECONDARY MARKET FOR LIFE INSURANCE POLICIES

## REPORT TO THE DELAWARE STATE SENATE PURSUANT TO SENATE RESOLUTION NO. 19

## DECEMBER 28, 2016

# I. INTRODUCTION

On June 30, 2016 the Delaware State Senate adopted Senate Resolution No. 19 ("S.R. 19"), requesting the Delaware Department of Insurance (the "Department") to examine the secondary market for life insurance policies and make recommendations for possible legislation.[1] The recitals in S.R. 19 noted the importance of life insurance and retirement annuities as family assets, accounting for an estimated one-sixth of Americans' long-term savings. S.R. 19 also noted that many universal and variable universal life insurance policies are lapsed by seniors over age 65. So-called "life settlements," whereby an insured sells an in-force life insurance policy to a third party for more than its cash surrender value but less than the face value of its death benefits, provide seniors with an option to lapsing policies. Life insurance policies sold in this way, in the "secondary market," may be held in trusts in Delaware financial institutions. S.R. 19 recited that "some life insurance carriers operating in Delaware have failed to pay death benefits, creating uncertainty in the Delaware life secondary market," and that the General Assembly has an interest in protecting seniors and ensuring a robust life settlement market for Delaware seniors.

For these reasons, S.R. 19 requested the Delaware Department of Insurance "to examine this issue to provide the necessary certainty to investors who purchase policies in the secondary market, which benefits Delaware consumers – particularly senior citizens – by giving them the chance to sell a life insurance policy that they no longer want or need for a substantially higher price than the cash surrender value of the policy." The Resolution requested that this examination provide guidance regarding the issues raised by the reported actions of some insurance companies to refuse to pay benefits to owners' of life insurance policies sold on the secondary market, "including the impact on local Delaware financial institutions which hold these policies in an established Delaware trust." The Resolution also requested that the examination "should address what policies or rules should be established to avoid expensive and

[1] S.R. 19 is available at http://legis.delaware.gov/BillDetail?legislationId=24146.

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unnecessary litigation for owners of life insurance policies issued in Delaware." Finally, S.R. 19 said that the Department should consider whether legislation would be appropriate, and, if so, to submit "any legislative proposals deemed meritorious in continuing and promoting the adoption and use of the State's law related to life settlements."

As part of the examination requested by S.R. 19, the Department surveyed all life insurance companies doing business in Delaware. The objective of this survey was to determine the number and amount of individual and group life insurance which had been sold, or "viaticated," and to identify the practices of Delaware life insurers regarding viaticated life insurance policies and life settlements. The results of the survey are discussed below in Section II.C. regarding the secondary market for life insurance policies in Delaware.

The Department also conducted a public information session on November 22, 2016, at the Department's office in Dover. The purpose of this session was to gather information consistent with the mandates of S.R. 19, specifically whether legislation is advisable or inadvisable to address the issues discussed in the Resolution, and why; what form any recommended legislation should take; the experience of Delaware and other states related to regulation of life settlements; and how best to protect the interests of life insurance consumers. Notice of the public information session was distributed to members of the State Senate and to all parties who had expressed interest to the Department in S.R. 19, and was posted on the Department's website and on the State of Delaware Public Meeting Calendar. Approximately twenty-five persons attended the session, and oral comments were made on behalf of Fortress Investment Group, a member of the Institutional Longevity Market Association; the American Council of Life Insurers; USAA; American International Group and Genworth Financial Assurance Corporation; State Farm Life Insurance Company; and Hon. Harris B. McDowell III.

In addition to conducting the public information session, the Department solicited written comments. At the request of a commenting party, the deadline for such comments was extended to November 28, 2016. Written comments were received from Hon. Brian J. Bushweller, the Life Insurance Settlement Association, the American Council of Life Insurers, and Sen. McDowell.

Both the oral comments presented at the public information session, and the written comments submitted, are summarized below in Section III. In addition, all written comments are posted on the Department's website[2] as is a transcript of the public information session. [3]

# II. BACKGROUND

A. Viatical Settlements

It has long been recognized that a life insurance policy is personal property that a policy owner has the right to sell or assign. *Grigsby v.* Russell, 222 U.S. 149 (1911); *accord PHL Variable Insurance Co. v. Price Dawe 2006 Insurance Trust*, 28 A.3d 1059 (Del. 2011). The sale or assignment of life insurance policies under certain, limited circumstances, is regulated by the Delaware Viatical Settlements Act, 18 DEL. C. § 7501 *et seq.* (the "Act"). In pertinent part, the Act defines a "viatical settlement contract" as:

> [A] written agreement entered into between a viatical settlement provider and a viator [the owner of a life insurance policy or a certificate holder under a group policy insuring the life of an individual with a catastrophic, life-threatening or chronic illness or condition]. The agreement shall establish the terms under which the viatical settlement provider will pay compensation or anything of value, which compensation is less than the expected death benefit of the insurance policy or certificate, in return for the viator's assignment, transfer, sale, devise or bequest of a death benefit or ownership of all or a portion of the insurance policy or certificate of insurance to the viatical settlement provider.

18 DEL. C. § 7502(6). The purchaser of the life insurance policy or certificate becomes the new policy owner or certificate holder, designates the beneficiary or beneficiaries, and is responsible for paying future premiums.

Viatical settlements, or "life settlements" as they have become known,[4] were developed in the mid-1980's, initially to enable AIDS patients to sell their life insurance policies for more than the cash

[2] http://www.delawareinsurance.gov/docs/pdfs/Senate-Resolution-19-Public-Comments-Nov-2016.pdf
[3] http://www.delawareinsurance.gov/docs/pdfs/Senate-Resolution-19-Public-Info-Session-Transcript-112216.pdf)
[4] In life insurance industry parlance, a distinction usually is made between "viatical settlements," referring to the sale of life insurance policies by policy owners with very short life expectancies, commonly individuals with terminal illnesses, and "life settlements," referring to such transactions by policy owners who are not seriously ill. Because the Act does not make this distinction, however, this report uses the term "viatical settlements" to refer generally to the sale or assignment of life insurance policies or certificates.

surrender value. Viatical settlements were used to provide such terminally ill persons with money for medical and living expenses as they neared the end of their lives. It was for this reason that the Act, which was enacted in 1999, defines a "viator" somewhat narrowly, to include only individuals "with a catastrophic, life-threatening or chronic illness or condition." 18 DEL. C. § 7502(8).

B. The Secondary Market

The "secondary market" refers to the sale, assignment or other transfer of the ownership of life insurance policies, including any benefits payable thereunder. A life settlement industry has emerged over the last 25 years, enabling policy owners "who no longer need life insurance to receive necessary cash during their lifetimes. The market provides a favorable alternative to allowing a policy to lapse, or receiving only the cash surrender value." *PHL Variable Life Insurance Co.*, 28 A.3d at 1069. In the secondary market, companies purchase policies of individuals, typically seniors, who are not necessarily seriously ill, and don't need the protection of insurance, but do need cash for retirement, medical and other living expenses. At the time of the 2013 Florida study discussed below, it was estimated that more than $35 billion worth of life insurance policies had been sold through the secondary market.

C. Delaware Law Governing Viatical Settlements

1. Viatical Settlements Act of 1999

In 1999, Delaware responded to the development of the secondary market by adopting the Viatical Settlements Model Act promulgated by the National Association of Insurance Commissioners. As noted, because the secondary market developed with the sale of life insurance policies by terminally ill policy owners, the scope of the Act is limited to viatical settlements by insureds who have a catastrophic or life threatening illness or condition. 18 DEL. C. § 7502(8). The Act requires the licensure of viatical settlement providers, brokers and agents (18 DEL. C. § 7503), and the approval by the Insurance Commissioner of viatical settlement contract and disclosure statement forms (18 DEL. C. §7504). The Act specifies a number of required disclosures when a policy owner applies for a viatical settlement, including about possible alternatives, tax consequences, potential claims of creditors, impact on eligibility for Medicaid or other government benefits, possible forfeiture of rights under the life insurance policy or

certificate, the timing of payment of the proceeds of the settlement, and the right to rescind the agreement. 18 DEL. C. § 7507(a). Additional disclosures must be made prior to the date the viatical settlement contract is signed, including about the affiliation, if any, between the viatical settlement provider and the issuer of the policy to be viaticated; possible loss of coverage on other lives under a joint policy; and the value of current death benefits payable to the provider, and any other benefits the provider will obtain an interest in as a result of the settlement. 18 DEL. C. §7507(b).

Under the Act, the viatical settlement provider must pay the proceeds of the settlement into an escrow or trust account immediately upon receipt of all documents necessary to enable the transfer of the life insurance policy. 18 DEL. C. §7508(d). Once the policy is transferred, the escrow agent or trustee must immediately disburse the proceeds to the viator, *id.*, and, in any event, payment must be made within two business days after the provider has received confirmation from the life insurer or group administrator that the policy or certificate has been transferred. 18 DEL. C. §7507(a)(6). The viator has an unconditional right to rescind the agreement for at least 15 calendar days from the receipt of the settlement proceeds. 18 DEL. C. §7508(c).

The Act prohibits the disclosure of the identity of the viator, unless the viator has consented, or the disclosure is necessary as part of a government investigation. 18 DEL. C. §7505(b)(1) and (2). Disclosure also may be made if required by a term or condition of the transfer of the viaticated policy by one settlement provider to another. 18 DEL. C. §7505(b)(3). Finally, the Act requires each viatical settlement provider to file with the Commissioner an annual statement. 18 DEL. C. §7505(a).

2. Delaware Caselaw

(a) Stranger-Originated Life Insurance (STOLI)

Virtually all jurisdictions, including Delaware, prohibit third parties from procuring life insurance policies for the benefit of persons or entities that have no relationship to the insured. Under long established Delaware common law, the party procuring a life insurance policy must have an "insurable interest" in the life of the insured person. *Baltimore Life Ins. Co. v. Floyd*, 91 A. 653 (Del. Super. 1914), *aff'd* 94 A. 515 (Del. 1915). Where a party lacking an insurable interest procures a policy directly or by

assignment on the life of another, "the transaction is mere speculation … contrary to public policy, and therefore void." *Id.* In 1968, the General Assembly codified the insurable interest requirement in 18 DEL. C. § 2704(a).

> Any individual of competent legal capacity may procure or effect an insurance contract upon his or her own life or body for the benefit of any person, but no person shall procure or cause to be procured any insurance contract upon the life or body of another individual unless the benefits under such contract are payable to the individual insured or his or her personal representatives or to a person, having, at the time such contract was made, an insurable interest in the individual insured.

The statute specifies categories of persons who have an insurable interest and who may procure "or cause to be procured" life insurance on the insured. These categories include anyone having a "lawful and substantial economic interest" in the insured's life, such as an employer or parties to contracts for the purchase or sale of a business, and relatives having a "substantial interest engendered by love and affection." 18 DEL. C. § 2704(c).

As the life settlement business evolved, certain investors moved beyond purchasing existing policies from insureds who no longer need them, to an arrangement in which an insurance agent or life settlement broker persuades a senior, often with a short life expectancy, to take out a life insurance policy not for the purpose of protecting beneficiaries, but as an investment, with the intention of selling the policy to an investor in the secondary market. These arrangements are known as "stranger-originated life insurance" ("STOLI"). Typically, STOLI policies have a high face value, and proportionately higher premiums. The life settlement company may lend the insured money to pay the premiums for the duration of the applicable contestability period, after which the company purchases the policy and assumes responsibility for paying the premiums. Commonly, the insured establishes an insurance trust, with his or her spouse and/or children as beneficiaries, and an investor either purchases the beneficial interest or purchases the policy and changes the beneficiary designation to an investment entity.

STOLI is problematic because the life settlement broker or company has no insurable interest in the life of the insured, making the transaction a gamble by the investor on how long the insured will live. Such arrangements are against public policy, and are prohibited by statute in most states. Most of the

Delaware cases that have addressed viatical settlements have done so in the context of an alleged STOLI transaction.

(b) Delaware Cases

The leading Delaware case on viatical settlements is *PHL Variable Insurance Co. v. Price Dawe 2006 Insurance Trust*, 28 A.3d 1059 (Del. 2011) ("*Price Dawe*"). In *Price Dawe* a life insurer sought a judicial declaration that a viaticated policy lacked an insurable interest, and so was void as an illegal contract wagering on a human life. Mr. Dawe had formed a Delaware statutory trust, with a family trust as the beneficiary. Mr. Dawe was the beneficiary of the family trust. Three months after the statutory trust was formed, Mr. Dawe procured a $9 million life insurance policy from PHL Variable Insurance Company ("Phoenix"), with the Dawe family trust as the owner and beneficiary. Less than two months after the policy became effective, an unrelated third party investor, GIII, purchased the beneficial interest from the Dawe family trust for $376,111. Mr. Dawe died three years later, and Phoenix contested payment of the death benefit on the grounds that Dawe misrepresented his income and assets, had no legitimate need for a $9 million life insurance policy, and was financially induced to participate in the transaction as part of a STOLI scheme. Phoenix argued that Mr. Dawe never intended to retain the policy, and always planned to transfer it immediately to GIII in exchange for the payment to the family trust, and thus there was no "insurable interest" in the policy at its inception, making it void.

The Delaware Supreme Court confirmed the right of policy owners to sell their life insurance policies, and held that (1) Phoenix had the right to challenge the validity of the policy, despite the expiration of the contestability period; (2) Delaware law did not prohibit Dawe from procuring a policy on his life and immediately transferring the beneficial interest to an investor without an insurable interest, even if Dawe never intended to provide insurance protection to a person with an insurable interest, provided that Dawe did not procure the policy as a mere cover for a wager by the investor; and (3) Section 2704 confers an insurable interest upon the trustee of a Delaware trust established by an individual insured, even when, at the time of the application for life insurance, the insured intends to transfer the beneficial interest in the trust to a third-party investor without an insurable interest, provided

that the insured actually established and initially funded the trust. As to the final point, the Supreme Court held that where an investor "either directly or indirectly funds the premium payments as part of a pre-negotiated arrangement with the insured to immediately transfer ownership, the policy fails at its inception for lack of an insurable interest." *Id.* at 1078. The Supreme Court's opinion in *Price Dawe* provides a thorough analysis of Delaware law regarding insurable interests, STOLI, and Delaware trusts, and establishes clear rules for determining the validity of viatical settlements.

Two Delaware federal court cases decided before *Price Dawe* also addressed alleged STOLI schemes. In *Lincoln National Life Insurance Co. v. Snyder*, 722 F.Supp.2d 546 (D.Del. 2010), a life insurer sued the trustee of a life insurance trust, an insurance agent, and a third party producer, alleging that the defendants fraudulently procured an $18.5 million life insurance policy. The agent and the third party allegedly persuaded a 76-year old man to apply for the policy, not for any legitimate insurance need but as a wagering contract on his life to sell to investors in the secondary market. The insurer alleged various fraudulent acts by the defendants in procuring the policy, including misrepresenting the insured's net worth and annual income, and failure to disclose an arrangement whereby the insured established the life insurance trust, with the intent to immediately transfer the beneficial interest in the policy, upon receipt of a previously agreed payment. The insurer issued the policy, and paid more than $1 million in commissions to the agent and the producer. Three years later the insured died, a death benefit claim was submitted, and the claim investigation by the insurer allegedly revealed the STOLI scheme. The insurer sought recission of the policy, and a declaration that it could retain the premiums paid. The court held that the insurer's allegations were sufficient under Delaware law to seek recission based on the lack of an insurable interest at the policy's inception, but that, if the policy was rescinded, the insurer would have to refund any premiums paid. A similar STOLI scheme was alleged in *American General Life Insurance v. Goldstein*, 741 F. Supp.2d 604 (D.Del. 2010), in which the federal court upheld the insurer's right to pursue an action to rescind the policy, and to seek damages for an alleged civil conspiracy to defraud in the insurer.

The most recent Delaware case involving viatical settlements is *Wilmington Savings Fund Soc'y v. PHL Variable Insurance Co.*, 2014 WL 1389974 (D.Del. 2014). In its capacity as the successor Delaware trustee of 60 life insurance trusts, Wilmington Savings Fund Society ("WSFS") sued two Phoenix life insurers, seeking damages including return of premiums paid, based on an alleged scheme by Phoenix to refuse to honor viaticated policies to avoid paying benefits, and to undermine or destroy the secondary market. The case involved large face amount policies, purchased through trust vehicles, which the insurers alleged were STOLI with no insurable interests. Although the court dismissed virtually all of the trustee's claims, it applied the rules set down by the Delaware Supreme Court in *Price Dawe*, and denied a motion by Phoenix to dismiss the case on STOLI grounds, holding that the trustee had pled sufficient facts to state a claim that the trusts had insurable interests in the lives insured under the Phoenix policies. The court concluded that the trustee had set forth a plausible case that the various trusts were not illegal wagers, noting that the investor who purchased the beneficial interests in the life insurance policies did not fund the trusts. *Id.* at *9-10. *Compare PHL Variable Ins. Co. v. ESF QIF Trust*, 2013 WL 6869803 (D.Del. 2013) (denying a motion to dismiss a similar case involving Phoenix, because the trusts in a fraud counterclaim pled sufficient details of the alleged business decision by Phoenix to systematically refuse to pay death benefits under the viaticated policies). The WSFS case eventually settled, without a ruling on the merits of the trustee's claim against Phoenix.

C. The Secondary Market for Life Insurance Policies in Delaware

1. Delaware Viatical Survey

As part of the analysis requested by S.R. 19, the Department surveyed all active life insurers conducting business in Delaware to determine the number and amount of individual life and group life policies viaticated, and to learn the practices of such insurers regarding life insurance policies and settlements. The survey was submitted to 91 life insurance companies – 64 individual life companies and 27 group life companies. Of the 91 companies surveyed, only 7 individual life and 3 group life companies did not respond.

The survey comprised a number of interrogatory questions. For both individual life and group life companies, the survey asked for the total count of Delaware in-force policies as of December 31, 2015; the total sum of the face amounts of such policies; the total count of viaticated policies and the sum of the face amounts of such policies; and an estimate of suspected viaticated policies and their total face amounts. The survey also asked whether each company has procedures in place to evaluate the impact of viaticated policies on the net present value of the insurer's life insurance book of business, and, if so, asked for an explanation of such procedures. Finally, the survey asked each company to identify the officer who reviewed the submitted data and would attest that the information provided was accurate.

A total of 25 companies reported viaticated policies which were known or suspected as of December 31, 2015. Of the 57 individual life insurance companies responding, 14 reported known viaticated policies and 7 others reported suspected viaticated policies. Of the 24 group life insurance companies responding, 2 reported known viaticated policies and 1 other reported suspected viaticated policies. Out of a total of 340,941 individual Delaware life insurance policies in force, the responding companies reported 140 known and 361 suspected viaticated policies. The total face value of the known and suspected viaticated individual life insurance policies is $2,519,775,847 (i.e., approximately $2.5 billion); the total face value all individual Delaware insurance policies is $71,472,632,838 (i.e., approximately $71.5 billion). Out of a total of 69,204 Delaware group life policies in force, the responding companies reported just 5 known and 1 suspected viaticated policies. The total face value of these known and suspected group life policies is $1,784,000 (i.e., approximately $1.8 million); the total face value of all group life policies is $328,225,826,304 (i.e., approximately $328 billion).

Of the 81 responding companies, only 6 have procedures in place to evaluate the impact of viaticated policies on the net-present value of their life insurance books of business

Based on the survey responses, viaticated policies represent a very small portion of total number and aggregate face value of in-force Delaware life insurance policies. Known and suspected viaticated individual life policies comprise less than 1% of all policies in force. The total face value of viaticated individual life policies is significant – about $2.5 billion – though again it represents a small percentage –

3.5% – of total face value of all individual life policies in force. Perhaps unsurprisingly, the viaticated policies typically have very large face values, averaging about $5 million. Viaticated group life policies represent an infinitesimal portion of the all group life policies, both in number and value – less than one-thousandth of 1%. The $300,000 average face value of viaticated group life policies is very small compared with viaticated individual life policies.

2. Consumer Complaints

The Department has received no complaints from Delaware consumers regarding viatical settlements or the secondary market, nor has the Department received any complaints from Delaware consumers regarding "cost of insurance" rate increases on in-force life insurance policies and annuities.

The only complaint ever received by the Department that may have indirectly related to viatical settlements was a 2012 complaint from U.S. Bank National Association ("U.S. Bank") about a cost of insurance rate increase by Phoenix on an in-force universal life policy owned by U.S. Bank as securities intermediary for Lima Acquisition LP. This issue is the subject of litigation between U.S. Bank and Phoenix, initially filed in federal court in Delaware in 2013, but later transferred to Connecticut. This litigation remains pending.[5]

# III. COMMENTS AND PROPOSALS

A. Fortress Investment Group

Jeremy Kudon, Esq., spoke at the Public Information Session on behalf of Fortress Investment Group ("Fortress"), which is a member of the Institutional Longevity Market Association, and an investor in the secondary market. Mr. Kudon noted that for five years Fortress has been lobbying, in Delaware and other states, for legislation to "provide some much needed certainty to the secondary life insurance market." Transcript of Public Information Session, Nov. 22, 2016, at 8 (hereinafter "Tr. at __"). Mr. Kudon stated that 80% of life insurance policies expire before any benefits are paid. He said that the

[5] The Department received a letter regarding cost of insurance increases from the Institutional Longevity Markets Association (ILMA) in November 2015.

secondary market affords life insurance policy owners, and particularly seniors, with a valuable alternative to allowing their policies to lapse, or selling them back to the insurer for their cash surrender value. Instead of getting, e.g., less than 4% of the face value of the policy by cashing it in, a policy owner can sell a policy to an investor in the secondary market for five or even ten times that amount.

According to Mr. Kudon, certain life insurers responded to the growing secondary market by refusing to pay death benefits. More recently, he said, certain insurers attempted to deter investors by increasing the "cost of insurance" rates on policies. And, because most states, including Delaware, prohibit life insurers from discriminating among classes of policyholders, such cost of insurance increases were inflicted not only on investors in the secondary market, but on consumers as well. Mr. Kudon noted that the New York Department of Financial Services had responded to this tactic by proposing regulations requiring life insurers to meet certain criteria before increasing the cost of insurance rates on in-force policies. Tr. at 15.

Mr. Kudon stated that the solution to this problem is simple, and recommended legislation covering four points:

> Adequate notice. Carriers should be required to give ample notice to consumers when [cost of insurance] rates are increased;
>
> Transparency. Carriers must be required to communicate the actual factual basis for their cost of insurance rate increases;
>
> Regulatory oversight. Regulators should be given the authority to review proposed cost of insurance rate increases in advance to ensure that they are justified and factually supported; [a]nd
>
> Remedies. Policyholders must be given clear remedial measure, short of filing an expensive lawsuit, that will allow for some review of credibility and justification of the proposed cost of insurance rate increase.

Tr. at 16.

Mr. Kudon was asked whether Fortress would support adoption of the National Association of Insurance Commissioners Viatical Settlements Model Act ("NAIC Model Act") to protect consumers. Mr. Kudon said that Fortress "would support it, but we would want to have something that addresses cost of insurance rate increases…." Tr. at 23.

B. American Council of Life Insurers

Leah Walters spoke at the Public Information Session on behalf of the American Council of Life Insurers ("ACLI"), and, following the Session, submitted written comments regarding the issues raised by S.R. 19. ACLI is a national trade organization representing more than 238 life insurance companies licensed in Delaware, of which 27 are domiciled in this State. According to Ms. Walters, ACLI members account for 91% of the total life insurance coverage in Delaware, and in 2014 paid $4 billion to Delaware residents in the form of death benefits, matured endowments, policy dividends, surrender values and other payments.

Ms. Walters acknowledged that ACLI has opposed legislation proposed by Fortress over the years. She said that it is very clear that the legislation proposed by Fortress is aimed at a single life insurer,[6] whose business practices have been the subject of extensive litigation over the years. Ms. Walters specifically mentioned the WSFS case discussed above at pages 10-11, and said that the court system, not the legislature, is the appropriate place where this fight between the companies should play out.

Ms. Walters referred to a similar study by the Florida Office of Insurance Regulation of the secondary market issues discussed in S.R. 19 (the "Florida Report"). She quoted from the conclusion of the Florida Report:

> Based on the materials submitted and the testimony provided, there appears to be adequate protection for purchasers of life insurance policies in the secondary life insurance market to ensure that the market continues to exist. There is significant concern that enacting these legislative changes may have the unintended consequences of encouraging STOLI and fraud.

Tr. at 18-19. On behalf of ACLI, Ms. Walters echoed this concern, and said that the life insurance industry objects to the legislation proposed by Fortress "for several reasons, but most importantly, we don't want Delaware to become the dumping ground for illegal STOLI policies that are written in other

[6] Several commenters referred obliquely to an ongoing fight between two companies, without specifically identifying the companies. It is clear, however, that the references were to Phoenix Life Insurance Company and Fortress.

states but transferred to Delaware via a Delaware trust." Letter from Leah J. Walters to Ms. Rhonda West dated Nov. 28, 2016. at 2 ("Walters Letter") . Regarding the finding of the Florida Report regarding the viability of the secondary market, Ms. Walters noted that, when compared to the seventeen licensed viatical settlement providers in Florida, a state with twenty times the population of Delaware and more seniors than any other state, Delaware's nine providers and five brokers suggest a robust secondary market in this State.

Ms. Walters disagreed with Mr. Kudon's testimony regarding lapse rates. She pointed to a 2016 study that reported lapse rates at a 20-year low. Regarding cost of insurance rate increases, Ms. Walters said that the life insurance industry is prepared to discuss the policies which provide for such increases, but noted that "[t]his issue has not been raised as a concern of the secondary life insurance market before and is an issue that is not specific to seniors or the secondary life insurance market. Accordingly, we respectfully suggest that this issue is outside the scope of SR19." Walters Letter at 2-3.

Given the lack of complaints by consumers, and the absence of any evidence that seniors are having difficulty selling their life insurance policies or that there have been problems in Delaware's secondary market, ACLI does not think any legislation is needed.

At the Public Information Sessions, Ms. Walters also was asked about the NAIC Model Act. She said that ACLI would support adoption of the NAIC Model Act, which she described as "an absolute great consumer protection piece of legislation." Tr. at 22-23. Ms. Walters said that adopting either the NAIC Model Act or the model act of the National Council of Insurance Legislators (NCOIL) "is fine as long as they are pure and ... not … tinkered with." Tr. at 22.

C. USAA

Mr. Taylor Cosby testified at the Public Information Session on behalf of USAA (United Services Automobile Association), a diversified financial services group of companies that provides services, including life insurance, to present and former military personnel and their families. Mr. Cosby stated that USAA consistently has opposed the legislation proposed by Fortress. He said that USAA has a major concern about its members who are seniors, and who may get involved in a life settlement induced

by fraud. But he noted that none of USAA's Delaware policyholders, nor any of its insurers, has ever complained about any problems with viatical settlements or the secondary market. According to Mr. Cosby, USAA consistently has endorsed the NAIC Model Act as the solution to any such concerns.

D. American International Group/Genworth Financial Group

Rebecca B. Kidner, Esq. testified at the Public Information Session on behalf of the American International Group ("AIG") and Genworth Financial Group ("Genworth Financial"). Both AIG and Genworth Financial are members of ACLI, and Ms. Kidner said that they endorse Ms. Walter's comments. Ms. Kidner stated that Florida, and the vast majority of states, have adopted some form of model legislation regarding life settlements, and AIG and Genworth Financial support adoption of either the NAIC or NCOIL model act in Delaware. She said that "there is widespread support in the industry for adopting either of those models in their pure form." Tr. at 26.

E. State Farm Insurance Company

W. Laird Stabler, III, Esq. testified at the Public Information Session on behalf of State Farm Insurance Company. Mr. Stabler characterized the legislation proposed by Fortress as "a solution in search of a problem." Tr. at 28. He said that the secondary market in Delaware is viable, and noted that there has been no testimony that any Delaware insured has had any problem selling a life insurance policy. Mr. Stabler said that "this is a fight between two big dogs … and it's not something the General Assembly needs to get involved in." Tr. at 29. State Farm does not believe that any legislation is necessary, but that either the NCOIL or NAIC model act is fine. Regarding the supposed "cost of insurance" problem, Mr. Stabler said that, though the issue may well be worthy of consideration at another time, it is outside the scope of S.R. 19.

F. Life Insurance Settlement Association

The Life Insurance Settlement Association ("LISA") submitted written comments regarding the questions posed by S.R. 19. LISA is an organization representing participants in the life settlement industry, with a current membership of more than 80 companies doing business in all 50 states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands. LISA's mission is "to promote the

development, integrity and reputation of the life settlement industry, to advance the highest standards of practice and professional development for the industry, and to educate consumers and advisors about a life settlement as an alternative to lapse or surrender of a life insurance policy." Letter from LISA to Rhonda West received on Nov. 28, 2016, n. 1.

LISA's comments noted that "no consumer complaints have been reported to the Delaware Insurance Department or to state insurance regulators nationwide over the past several years." *Id.* at 2. According to LISA, Delaware is among a minority of states that have not adopted any life settlement legislation since at least 2007, and that the current Delaware Act only regulates the sale of policies by individuals who have been diagnosed with a terminal or chronic illness, "which has become a tiny part of the secondary market." *Id.* LISA supports "public policy that reinforces the benefits of the life settlement market for consumers as a transparent and well-regulated transaction, while recognizing the bright line distinction between life settlements and STOLI." *Id.*

LISA's comments stressed the value of life settlements, particularly to seniors in retirement, and expressed concern about the "millions of life insurance policies [which] lapse or are surrendered by consumers" annually. *Id.* at 3. LISA pointed to certain studies and articles "illustrating a clear lack of knowledge by both consumers and their advisors as to their options." *Id.* LISA said that, recognizing this problem, NCOIL adopted a Life Insurance Consumer Disclosure Model Act, which requires that "notice be provided to consumers over the age of 60 who are terminally or chronically ill or considering lapse or surrender of their life insurance policy, notifying them of eight different alternatives to lapse or surrender, one being a life settlement." *Id.* 3-4. According to LISA, six states have adopted the NCOIL Model Act or some other form of consumer disclosure law.

In its comments LISA addresses STOLI, stressing that, because the illegal conduct in such transactions occurs at the inception of the policy, "STOLI is neither a secondary market transaction nor a life settlement transaction." *Id.* at 4. LISA and its members strongly support business practices and legislation that target the elimination of STOLI. The LISA comments also discussed the Delaware Supreme Court decision in the 2011 *Price Dawe* case, noting the court's recognition that "an insured has

a common law property right to purchase a policy on his own life and sell it for market value, provided, of course, that procurement of the policy is not part of a straw purchase pursuant to a prior agreement to resell to an investor." *Id.* at 5.

Regarding the specific questions posed by S.R. 19, LISA agreed that "[s]ome insurance companies have acted to thwart the secondary market for life insurance, including life settlements, through a variety of acts that have harmed Delaware consumers, including actions relating to the payment of benefits to owners of life insurance policies that were sold in the secondary market. Investors in such policies should be protected against such actions." *Id.* at 6. LISA supports regulation that avoids policy owners having "to endure expensive and unnecessary litigation due to the actions of insurers relative to the payment of benefits to such owners." *Id.* But LISA reserves endorsement of any specific legislation until it is introduced. As for model legislation, LISA supports the NCOIL Life Settlements Model Act.

G. Comments from Legislators

1. Hon. Brian J. Bushweller

Prior to the Public Information Session, Sen. Brian Bushweller submitted written comments pertaining to S.R. 19. Sen. Bushweller recounted recent efforts to enact legislation in Delaware regarding life settlements and the secondary market. He referred specifically to Senate Bill 71, which he said was a Fortress proposal aimed at Phoenix. Sen. Bushweller noted that there has been extensive litigation between Fortress and Phoenix in several other states, but there is no pending litigation between them in Delaware. Sen. Bushweller referred to the WSFS lawsuit against Phoenix discussed above, which he said has been settled. There being no remaining litigation in Delaware involving Fortress, Phoenix or WSFS, Sen. Bushweller said there is no need for legislative action such as that proposed in Senate Bill 71.

Sen. Bushweller expressed concern that, if legislation like Senate Bill 71 is enacted, Delaware may become a haven for STOLI and fraud, saddling Delaware courts with litigation concerning life insurance policies written in other states. Sen. Bushweller echoed the Florida Report on this point. He noted that, as part of the study leading to the Florida Report, Fortress submitted a five-point legislative proposal, including monitoring "cost-of-insurance" rate increases. Sen. Bushweller noted that the Florida

Report concluded that current laws governing the secondary market adequately protected purchases of life insurance policies in that market, and that, to the extent there have been problems, "the courts are addressing these issues by applying equitable principles based on the fact-specific circumstances of each case." Letter from Hon. Brian J. Bushweller to Hon. Karen Weldin Stewart dated Nov. 18, 2016, at 2. Sen. Bushweller agreed with the findings of the Florida Report, and recommends that no legislative action be taken regarding the secondary market.

2. Hon. Harris B. McDowell, III

Sen. Harris McDowell, one of the co-sponsors of S.R. 19, spoke at the Public Information Session and also submitted written comments. During the Session Sen. McDowell said that his conclusion based on what all the other speakers said is that "we need something in our law that is not there now." Tr. at 32. Sen. McDowell expanded on this in his written comments. He said that for years he has sponsored legislation to protect innocent investors in the secondary market, not because it would benefit any particular investor, "but because it will benefit the tens of thousands of Delaware seniors who own life insurance policies that they may no longer want or need." Letter from Hon. Harris B. McDowell, III to Hon. Karen Weldin Stewart received Nov. 28, 2016. Sen. McDowell said that there is "no dispute that Delaware seniors benefit from a robust secondary market, and that [a]n uncertain secondary market for life insurance hurts Delaware seniors." *Id.*

Sen. McDowell said that "Delaware has had its head in the proverbial sand on this issue," *id.*, noting that Delaware is one of only five states that do not have laws governing life settlements (as distinct from viatical settlements). "As a result of having no checks on insurers who are seeking to erode the secondary market, a wave of unfair cost of insurance increases have hit not just investors but all policy holders." *Id.* Sen. McDowell said that cost of insurance increases used to be extraordinary, but "because one carrier got away with it, other carriers are now following suit," *id.*, meaning that Delaware seniors could see premium increases for no reason. "And unlike other forms of insurance, life insurers aren't required to seek approval or give notice to the state before they increase rates." *Id.*

Sen. McDowell said that "[t]he Department should suggest ways to curb unfair cost of insurance increases and promote transparency and oversight in the process." *Id.* at 2. He concluded: "While some would rather we believe that this is just a fight between large companies we can't forget that Delaware seniors are affected by higher insurance costs and fewer alternatives to sell their policies. It is our duty to ensure they are protected." *Id.*

# IV. CONCLUSIONS AND RECOMMENDATION

Based on the materials reviewed and the comments provided, it appears that there is a functioning secondary market for Delaware life insurance policies. Ten viatical settlement providers are licensed in Delaware. Even though viaticated policies represent a very small portion of in-force life insurance policies in Delaware, the total face amount of viaticated policies is significant.

There is no apparent need for the legislation proposed by Fortress. It is true that most life insurance policies lapse before the payment of benefits, but there are many reasons why policy owners may decide to allow their policies to lapse. For example, term life policies are designed to provide protection only for a specified period, during which flat premiums typically are guaranteed. Such policies usually are renewable only at significantly higher premium rates, and, after the specified term, policy owners may simply no longer need the protection afforded by the coverage.

Fortress contends that some life insurers unfairly increase "cost of insurance" factors in the non-guaranteed elements of policies as a way to force policy owners to lapse their policies. Fortress points to a regulation recently proposed by the New York Department of Financial Services to support the argument that legislation is needed in Delaware to regulate "cost of insurance" rate increases. The New York regulation was proposed in response to consumer complaints, and following a finding by the Department of Financial Services that some insurers have not been implementing increases in the cost of insurance on older life insurance policies in accordance with approved policy provisions and the relevant provisions of New York law. Unlike the situation in New York, however, the Department has received

no complaints from Delaware consumers about "cost of insurance" rate increases.[7] Furthermore, the legislation Fortress proposes is far more extensive than the proposed New York regulation, and would fundamentally alter the regulation of life insurance premiums in Delaware. Finally, as several commenters pointed out, the "cost of insurance" issue is beyond the scope of S.R. 19, which does not even mention the issue.

As noted, in 2013 the Florida Office of Insurance Regulation undertook a virtually identical study as that requested by S.R. 19. As S.R. 19 also specifies, the focus of the Florida study was whether there are adequate protections for purchasers of life insurance policies in the secondary market to ensure that this market continues to exist for seniors. Florida and Delaware both adopted the NAIC Model Act, although, unlike Delaware, Florida has updated its law to reflect changes in the Model Act. Florida of course has a vastly larger population of seniors than Delaware. Also unlike Delaware, Florida has a history of problems in the secondary market, including complaints from consumers who invested in viaticals, pyramid schemes, an SEC investigation and criminal prosecution, and STOLI. During the Florida study, Fortress and others proposed legislative changes, including monitoring "cost-of-insurance" rate increases. Despite the much larger population of consumers for whom viatical settlements might be particularly valuable, and the history of problems in the secondary market, the conclusion of the Florida study was that its current law – essentially the NAIC Model Act – adequately protects purchasers of life insurance policies in the secondary market. Among other findings, the Florida Report noted that the legislative changes proposed by Fortress appeared to address the actions of a small number of life insurance companies -- and perhaps just one company -- and the courts are addressing alleged problems relating to such actions by applying equitable principles based on the fact-specific circumstances of each case. The Florida Report also noted a "significant concern that these legislative changes may have the unintended consequence of encouraging STOLI and fraud…. This treatment of life insurance solely as a

[7] As noted in section II.C.2. above, U.S. Bank, N.A. submitted to the Department in 2012 a complaint about a cost of insurance rate increase on a universal life policy issued by PHL Variable Life Insurance Company. The policy was owned by Lima Acquisition LP, which had acquired the policy in the secondary market, and for whom U.S. Bank served as securities intermediary. As indicated above, that matter is before the court in Connecticut.

commodity from inception is at odds with the purpose of life insurance and may have negative ramifications for the industry, to the detriment of Florida consumers, life insurance companies, and the legitimate viatical settlement industry." The Florida Office of Insurance Regulation, Secondary Life Insurance Market – Report to the Florida Legislature, http://www.floir.com/siteDocuments/ SecondaryLifeInsMarketReport2013.pdf, at 51 (Dec. 2013).

Current Delaware law enables the Department to act to protect consumers against abuses in the viatical settlement industry. The Act requires that viatical settlement contract and disclosure forms must be approved by the Commissioner. 18 DEL. C. § 7504. The Commissioner has the power to examine the business and affairs of any licensee or applicant for a license "to ascertain whether or not the licensee is acting or has acted in violation of the law or otherwise contrary to the interests of the public." 18 DEL. C. § 7504. Violations of the Act are deemed unfair trade practices under the Chapter 23 of the Delaware Insurance Code, enabling the Commissioner to investigate "to determine whether such person has been or is engaged in any unfair method of competition or in any unfair or deceptive act or practice prohibited by" the Delaware Unfair Trade Practices Act. 18 DEL. C. § 2306.

Even though there appears to be an active secondary market in Delaware, and there have been no complaints from Delaware consumers about viatical settlements, the Delaware Viatical Settlements Act should be updated. The Act currently is limited to viatical settlements by insureds with catastrophic illnesses, and the secondary market long ago moved beyond this limitation to encompass any policy owner who wants to sell his or her life insurance policy. At the time it was enacted in 1999, the current Delaware statute was the NAIC Model Act, but since then the Model Act has been revised, including to reflect changes in the secondary market.

The NAIC Viatical Settlements Model Act has been adopted in one form or another in more than 40 states. The current version of the NAIC Model Act differs from the current Delaware statute in numerous respects. The Model Act:

1. Is not limited to insureds with terminal or chronic illnesses or conditions;
2. Clarifies and expands licensing requirements for viatical settlement producers;

3. Expands confidentiality provisions to include an insured's financial status and medical information, and more strictly limits when such information may be shared;

4. Provides much greater detail regarding the Commissioner's authority to conduct investigations, the scope of such investigations and how they are conducted;

5. Clarifies record retention requirements;

6. Addresses conflicts of interest and immunity from liability;

7. Requires additional disclosures to a viator by viatical settlement providers and agents;

8. Clarifies and lengthens the period during which the viator may rescind a viatical settlement agreement;

9. Requires viatical settlement providers to notify an insured if ownership of the policy or the beneficiary designation is changed;

10. Requires that a viatical settlement broker or provider notify the insurer before completing a transaction or initiating a plan for a series of transactions;

11. Adds provisions regarding the prevention, detection and reporting of fraud, and defines "fraudulent viatical settlement acts;"

12. Specifically sets forth violations of the Act, including entering into a viatical settlement contract at any time prior to the issuance of a policy which is the subject of the contract, or within 5 years of the date of issuance of the insurance policy or certificate, unless the viator certifies to the viatical settlement provider that one or more specified conditions have been met within the 5-year period (e.g., the death of the viator's spouse or divorce), in which case the policy could be viaticated at any time; and

13. Empowers the Commissioner to seek an injunction against persons violating the Act, and provides for both civil and criminal penalties for violations.

All commenting parties support adoption of either the NAIC Viatical Settlements Model Act or the NCOIL Life Settlements Model Act. Fortress supports adoption of a model act, but only with the "cost of insurance" provisions it proposed. The American Council of Life Insurers, the American

International Group and Genworth Financial support adoption of either model act, but only without any modifications.

There have been a number of prior legislative Initiatives to update the Delaware Act. During the 145th General Assembly, Senate Bill 145 would have adopted the NCOIL Model Act, which is similar to the NAIC Model Act but also addresses STOLI in greater detail. S.B. 145 was not reported out of committee. During the last General Assembly, Senate Bill 71 would have addressed STOLI to a limited extent, including by requiring life insurers to return premiums paid for policies rescinded or determined to be void because they were fraudulently obtained by a person without an insurable interest. S.B. 71 was defeated in the State Senate and not reconsidered. Last year there was a bipartisan effort to mark up the NAIC Model Act as a basis for Delaware legislation, but consensus was not reached, and a bill was not introduced.

Based on the materials reviewed and the comments provided, the Department recommends the adoption of the current NAIC Viatical Settlements Model Act. Adoption of the NAIC Model Act would bring Delaware law up-to-date, most significantly by expanding its scope beyond viatical settlements by policy owners suffering from catastrophic illnesses to all owners of life insurance policies. The current Model Act also strongly discourages STOLI policies by limiting the policyholder's ability to sell a policy for a period of five years after issuance of the policy, subject to enumerated exceptions. The Department also recommends that the "cost of insurance" provisions proposed by Fortress not be adopted. Although this issue appropriately may be considered as part of an evaluation of Delaware laws generally regulating life insurance, and in particular the regulation of life insurance premiums, the stated concern about cost of insurance rate increases is beyond the scope of S.R. 19's focus on viatical settlements and the secondary market. Furthermore, there have been no complaints by consumers about access to the secondary market, or questionable practices by life insurers. Problems with cost of insurance rate increases appropriately have been addressed by the courts, based on the facts of each case.