

**YOU CAN BET YOUR LIFE ON IT!  
REGULATING SENIOR SETTLEMENTS TO  
BE A FINANCIAL ALTERNATIVE FOR THE  
ELDERLY**

*Jessica Maria Perez*

*As seniors struggle to keep pace with medical care costs and other expenses, many must look to alternative sources of financial freedom. Senior settlement agreements, through which a senior may sell her life insurance policy to a third party for a percentage of its future value, may provide one such alternative. In this Note, Jessica Maria Perez explores the history of senior settlement agreements from their birth as sisters to similar agreements made by the chronically ill, to the present in which they are increasingly entered into by healthy seniors. Perez analyzes the positive and negative aspects of these agreements from basic economic risk to ethical issues to tax implications. She analyzes recent regulatory developments in this area, including the Viatical Settlements Model Act and various state statutes. Perez recommends increased regulation at the state level, encouraging states to adopt the Model Act. She also recommends that these transactions be made tax-exempt and that attorneys play a greater role in the making of senior settlements. With these reforms, Perez suggests that the senior settlement agreement can be a safe and effective method by which seniors can realize financial freedom.*

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Jessica Maria Perez is Managing Editor 2002–2003, Member 2001–2002, *The Elder Law Journal*; J.D. 2003, University of Illinois, Champaign-Urbana; B.A. 1997, Accountancy, University of Notre Dame.

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## I. Introduction

When John was seventy-six, he suffered an unexpected and permanently disabling heart attack.<sup>1</sup> A once proud man, John must now contemplate how to finance his own long-term care. Unprepared for this unfortunate event, John's family has to consider the daunting cost of a care facility.<sup>2</sup> The family's only major asset is a \$500,000 life insurance policy, which is payable only upon the death of the insured.<sup>3</sup> What financial options do John and his family have?

There are several options a person carrying a life insurance policy has to obtain immediate financial benefits.<sup>4</sup> One could borrow against the cash surrender value of the life insurance policy, cash out the policy based on the available cash surrender value, obtain accelerated benefits if offered by the insurance company, borrow from friends or family using the life insurance policy as collateral, or sell the life insurance policy in a viatical or senior settlement.<sup>5</sup>

A senior settlement allows a person aged sixty-five or older to sell his or her life insurance policy at a discount to investors.<sup>6</sup> The investor's return is based on the life expectancy of the elderly policyholder.<sup>7</sup> The elderly person selling his or her discounted policy receives a lump-sum amount of money to spend on long-term care services, or anything else he or she wants or needs.<sup>8</sup>

This Note considers the use of senior settlements as a long-term care financing option and advocates for increased regulation of these settlements. Part II examines the history and development of the viatical settlement industry, which has led to the growth of the senior settlement industry. Part III analyzes recent regulatory developments in the senior settlement debate. Part IV recommends increased regula-

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1. This scenario is based on a case study presented in Welcome Funds' brochure (on file with author), available at <http://www.welcomefunds.com/senior-settlements.htm> (last visited Aug. 20, 2002) [hereinafter Welcome Funds].

2. *Id.*

3. *Id.*

4. The Viatical and Life Settlement Association of America, at <http://www.viatical.org/questions.html> (last updated Sept. 27, 2001).

5. *Id.*

6. *Id.*; see discussion *infra* Part II.C.1.

7. The Viatical and Life Settlement Association of America, *supra* note 4; see discussion *infra* Part II.C.1.

8. Barbara Looney, *Viatical Settlements—An Overview of the Use of Viatical Settlements as a Long-term Care Financing Option for the Elderly (Part I of III)*, NAELA Q., Fall 1995, at 11.

tion of the senior settlement industry as a means of keeping senior settlements as a viable financial alternative for the elderly.

## II. Background

### A. The Advent of Viatical Settlements

Knowing the history of senior settlements is an important first step toward understanding the existing regulation and financial treatment of these transactions. Senior settlements are actually part of a secondary market for life insurance policies that began with the viatical<sup>9</sup> settlement industry in the late 1980s, at the height of the Acquired Immune Deficiency Syndrome (AIDS) outbreak.<sup>10</sup> In the early 1990s, the average medical cost of AIDS treatment from the time of the onset of full-blown AIDS until death was approximately \$69,000 per patient.<sup>11</sup> The AIDS epidemic created a population of people with short life spans, high medical costs, and few assets other than life insurance policies.<sup>12</sup> In response to the financial needs of this fast growing population, viatical settlement companies quickly emerged onto the scene and accounted for “\$5 million in life insurance policies in 1989, to perhaps \$200 million in 1995.”<sup>13</sup> In need of quick cash, AIDS patients looked to viatical settlements for money they needed to pay medical costs, and the settlements typically provided investors with a high rate of return.

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9. The word “viatical” stems from the Roman Catholic term “viaticum,” which refers to the Eucharist or communion received prior to death. Its Latin definition is “journey money” or “money provided for a long journey.” WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE UNABRIDGED 2548 (3d ed. 1993).

10. See Ron Panko, *Playing the Death Pool*, BEST’S REV.—LIFE-HEALTH INS. ED., Apr. 1, 1999, available at 1999 WL 11979513.

11. Russell J. Herron, Note, *Regulating Viatical Settlements: Is the Invisible Hand Picking the Pockets of the Terminally Ill?*, 28 U. MICH. J.L. REFORM 931, 931–32 (1995). A 1992 survey distributed to 30,000 AIDS and HIV-positive people found that over fifty percent of respondents had difficulty paying for medication and basic necessities like food and housing. *Id.* at 932. Approximately thirty percent lived on less than \$500 per month, while another thirty percent fought to get by on less than \$1000 per month. *Id.*

12. Liza M. Ray, Comment, *The Viatical Settlement Industry: Betting on People’s Lives Is Certainly No “Exacta,”* 17 J. CONTEMP. HEALTH L. & POL’Y 321, 327 (2000).

13. SEC v. Life Partners, Inc., 898 F. Supp. 14, 17 n.1 (D.C. 1995).

## B. The Viatical Process Defined

The National Association of Insurance Commissioners (NAIC) adopted the Viatical Settlements Model Act (Model Act) in 1993,<sup>14</sup> and the Viatical Settlements Model Regulation (Model Regulation) in 1994.<sup>15</sup> The Model Act defines a viatical settlement contract as:

a written agreement establishing the terms under which compensation or anything of value will be paid, which compensation or value 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 the death benefit or ownership of any portion of the insurance policy or certificate of insurance.<sup>16</sup>

In a typical viatical settlement transaction, a terminally or chronically ill policyholder, known as a viator,<sup>17</sup> sells the right to the proceeds of his or her life insurance policy to an investor at a discount.<sup>18</sup> The viator immediately receives a lump-sum cash payout, ranging anywhere from fifty to eighty percent of the face amount of the life insurance policy, which he or she can spend without restrictions.<sup>19</sup> The sooner the viator dies, the higher the rate of return the investor realizes on his or her investment because the investor pays the life insurance premiums for the remainder of the viator's life.<sup>20</sup>

As an example of the typical viatical settlement process, assume John has annual insurance premiums of \$1,000 and a third-party investor purchases John's \$500,000 life insurance policy at a fifty percent discount. The investor would pay John \$250,000, and would pay his insurance policy premiums of \$1,000 annually for every year that John lives, thus conditioning the investor's rate of return on John's length of life. Once John dies, the investor would be entitled to the en-

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14. VIATICAL SETTLEMENTS MODEL ACT (Nat'l Ass'n of Ins. Comm'rs 1993), reprinted in Nat'l Ass'n of Ins. Comm'rs, Model Laws, Regulations and Guidelines § 697-1 to -17 (2001) [hereinafter MODEL ACT].

15. VIATICAL SETTLEMENTS MODEL REGULATION (Nat'l Ass'n of Ins. Comm'rs 1994), reprinted in Nat'l Ass'n of Ins. Comm'rs, Model Laws, Regulations and Guidelines § 698-1 to -11 (2001) [hereinafter MODEL REGULATION].

16. MODEL ACT, *supra* note 14, § 697-2.

17. The word "viator" means "traveler; wayfarer." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE UNABRIDGED, *supra* note 9, at 2548; see also *supra* text accompanying note 9.

18. Miriam R. Albert, *The Future of Death Futures: Why Viatical Settlements Must Be Classified as Securities*, 19 PACE L. REV. 345, 348 (1999).

19. Looney, *supra* note 8, at 11, 16. Some terminally ill policyholders have used the money to pay for medical bills, purchase gifts, or go on "dream" vacations. *Id.*

20. Daniel Eisenberg, *Making a Killing*, TIME, Nov. 29, 1999, at 108 ("Profitability is related to the predictability of death.").

tire \$500,000 policy payout from the insurance company. The investor's total return would be \$500,000 less the \$250,000 payment to John and the annual premiums paid to the insurance company on behalf of the viator.

### C. The Trend Toward Senior Settlements

With medical advances creating new drugs to extend the lives of persons with AIDS, investors began targeting life insurance policyholders with such deadly diseases as cancer and advanced heart disease.<sup>21</sup> In 1996, approximately eighty percent of settlements involved the life insurance policies of terminally ill individuals,<sup>22</sup> with the remaining twenty percent belonging to healthy elders.<sup>23</sup> Recently, these percentages have been reversed as the industry is now increasing its focus on the elderly with what have become known as senior settlements.<sup>24</sup> According to Florida State Senator, Steve Geller, Chairman of the Viatical Settlement Subcommittee for the National Conference of Insurance Legislators (NCOIL), “[t]he issue[s] of viatical and life settlements are hot topics in the insurance field right now. Today, the bulk of these transactions are not viatical (terminally ill) settlements, they are life settlements. The majority of the dollars are now in life settlements.”<sup>25</sup> Furthermore, this new market in senior settlements is driven by the fact that some elderly citizens no longer want, need, or can afford their life insurance policy coverage.<sup>26</sup>

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21. Marilyn Askin, *Viatical Settlements: A Yellow Brick Road*, 190 N.J. LAW 14, 14 (1998) (noting that, as of 1998, the insurance industry was targeting people with cancer, advanced heart problems, Lou Gehrig's disease, and Alzheimer's disease).

22. MODEL ACT, *supra* note 14, § 2(j) (defining the “terminally ill” as persons with an illness that can be expected to result in death within two years or less).

23. Kristina Stefanova, *Death Benefits Viaticals Industry Bruised by Fraud, New AIDS Drugs*, WASH. TIMES (D.C.), Aug. 23, 2001, at B11, available at 2001 WL 4160418.

24. *Id.* (As of 2001, only twenty percent of the industry caters to the terminally ill.)

25. Press Release, Mutual Benefits Corp., NCOIL (*The National Coalition of Insurance Legislators*) Adopts New Model Law Governing the Life Settlement and Viatical Industry (Nov. 11, 2000), at [http://www.mutualbenefitscorp.com/news\\_press\\_11\\_16\\_00.html](http://www.mutualbenefitscorp.com/news_press_11_16_00.html) (last visited Aug. 20, 2002) [hereinafter *NCOIL Adopts New Model Law*]; see also <http://www.ncoil.org> (discussing the history and purpose behind NCOIL).

26. John Hillman, *Life Settlement Coalition Launched to Educate Insurers*, BEST'S INS. NEWS, Aug. 14, 2001, 2001 WL 24724470.