Financial Planning or Fleecing of Seniors?: Insurance Products and Investments

Senate Insurance Committee

Hearing: February 27, 2003

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I. Introduction - Is there a problem?

The Federal Trade Commission estimates that Americans lose approximately $10 billion each year in fraudulent investments.[1] Even when the issue is not outright fraud, investors may be unfairly manipulated or their money may be seriously mismanaged. The number of complaints and inquiries received by and responded to by the Securities and Exchange Commission (SEC) has increased 88 percent since 1995. There was an 18 percent increase in just two years (1998 – 2000).[2]

During the past five years, the California Department of Insurance has received approximately 2500 complaints and inquiries that pertain to annuity products. DOI figures indicate that 25% of the complaints have involved senior citizens. However, cases involving seniors probably make up a much higher percentage of the complaints because DOI does not always identify the age of the complainant, and victims do not always disclose their age.

Older people are clearly attractive targets for scam artists. Seniors sometimes have significant assets. Seniors are generally worried about paying for long-term health care, protecting their assets for their heirs, and being a financial burden to their children and families. Therefore, they are likely to be interested in seminars about long-term care, estate planning with life insurance and annuities, and Medi-Cal qualification.

Even when they are not in the highest tax brackets, seniors are very tax sensitive and therefore interested in products that are touted as being tax-planning tools. Seniors want to be self-sufficient, so may not always consult with friends or reputable investment professionals who could offer reliable advice. They also may not have the technological resources to research companies (i.e. on the internet). Finally, they have time to attend seminars and presentations, which are often used to gather financial and personal information for later sales pitches (often in the seniors' homes).

The rate of fraud perpetrated on seniors may be even higher than available data suggests. According to consumer advocates, seniors are often reluctant to report that they have been victimized. According to the California Department of Social Services and the U.S. General Accounting Office, an estimated 225,000 incidents of adult abuse occurred in California in 1996, but only 44,000 (or less than one-fifth) were reported.[3] Ashamed to admit that they believed claims too good to be true (that both huge profits and safety were guaranteed), seniors may blame themselves for their losses. They may also fear that others will think that they are mentally incompetent if they disclose their unwise financial choices. Alternatively, they may truly be incompetent and therefore unable to seek help.

Another complication, not only for statistics, but also for prosecutors and regulators is the unfortunate reality that many elderly victims are deceased by the time fraud is uncovered. The deaths could be from natural causes, but may also be accelerated by their experience. Financial abuse may lead to diminished health or even death, according to the *Journal of the American Medical Association*, which found that elders who are victims of financial abuse have a mortality rate much higher than those who are not victims.[4] Therefore, relatively few financial abuse cases ever reach the court system. Those which do reach the courts or regulators are representative of dozens of others which never will.

II. The law regarding financial abuse of elders

A. Legislative history

In 1982, AB 1805 and SB 1210 were signed into law. Those bills established a mandated reporting law for physical abuse of elder or dependant adults - the Elder and Dependent Adult Civil Protection Act (EADACPA) –and established other special legal protections for seniors. However, the bills failed to provide sufficient funding for the increased statutory responsibility of investigating and pursuing those violators. Subsequent legislation refined the laws, but the focus remained on reporting abuse and criminally prosecuting abusers. In 1983, Penal Code §368 was enacted making elder abuse a "wobbler" (a crime that can be charged alternatively as a felony or as a misdemeanor.)

In 1991, SB 679 was signed into law. It expanded EADACPA to include private civil enforcement of laws against elder abuse and neglect. The legislature declared that "infirm elderly persons and dependent adults are a disadvantaged class, that cases of abuse of these persons are seldom prosecuted as criminal matters, and few civil cases are brought in connection with this abuse due to problems of proof, court delays, and the lack of incentives to prosecute these suits"[Welfare & Institutions Code (hereafter W&I)§15600(j)].

In 1998, SB 2199 (Lockyer) revised EADACPA by changing the term "fiduciary abuse" to "financial abuse" as defined by Section 15610.30 of the W & I Code. The Assembly Public Safety Committee's analysis of the bill included the following statement from the author about the need for the bill:

> "The current mandatory reporting requirement is limited to reporting physical abuse. Other equally abhorrent types of abuse, such as forced isolation, neglect, and financial exploitation, are not required to be reported. Moreover, the county service mandate is limited to receiving reports; they are not required to provide any emergency/treatment services or even investigate these reports. SB 2199 proposes a sweeping reform of both the state's elder and dependent adult reporting laws and our Adult Protective Services program. The proposal will not only expand the mandatory reporting law to cover isolation, neglect, and financial exploitation, but it will also set minimum statewide standards for service in all counties."

AB 2107 (Scott, Chapter 442, Statutes 2000) and SB 1742 (Hughes, Chapter 813, Statutes of 2000) made further changes to Section 15610.30 and made conforming changes to other provisions of EADACPA related to financial abuse of elders and dependent adults. All references to "fiduciary abuse" were changed to "financial abuse" so that the law applied to all those who take advantage of seniors, not just caretakers.

B. Current laws regarding elder abuse:

1. Criminal statutes:

Theory - The fraudulent acquisition of a victim's money can be prosecuted a number of different ways: under general criminal statutes such as those prohibiting theft (Penal Code sections 484, 487, or 666), the practice of law without a license (Business & Professions Code Sections 6125 et seq), theft by false pretenses (Penal Code Section 532), or even first degree residential burglary (Penal Code section 459).

Prosecutors can also file charges under more specific criminal statutes, such as Penal Code section 368 (d), which prohibits theft or embezzlement from seniors and dependent adults. If the defendant is a licensed insurance agent or broker, prosecutors could also file charges under Insurance Code Sections 781 or 782, which make it a misdemeanor (punishable by up to 6 months in jail and/or fine not exceeding two hundred dollars) to misrepresent the terms or conditions of an insurance policy with the intent to induce a person to take out a policy of insurance, choose one policy over another, lapse, forfeit, or surrender a policy.

Remedies – Criminal penalties can range from a small fine to a conviction for a serious felony (which would require a state prison sentence, and even a life sentence if the defendant has previously been convicted of specific prior felony convictions under the Three Strikes Law).

Problems – rarely used

2. *Civil statutes:*

a. EADACPA (see above) – prohibits financial abuse of seniors and dependant adults.

Theory - Plaintiffs must prove, by clear and convincing evidence that the defendant, by use of oppression, fraud, malice or reckless conduct or behavior, financially abused the victim. Plaintiffs must also show that the conduct was either intentional or reckless.

Remedies – Attorney fees, restitution, damages for pain and suffering, punitive damages can be recovered.

Standing – The Attorney General (AG), local prosecutors, and victims can sue

Problems – The standard of proof required is very high, and the elements of the cause of action (such as intent) are hard to prove. The law is very general. It is meant to cover virtually every imaginable type of physical or financial abuse.

b. Unfair Competition Law (Civil Code Section17200 et seq) – prohibits unlawful, unfair, or fraudulent business acts or practices.

Theory - The "Unfair Competition Law" (UCL) allows consumers to collectively sue for unfair business practices. An “unfair business practice” is any practice that is (1) unlawful, (2) unfair, (3) fraudulent, or (4) unfair, deceptive untrue or misleading advertising and any act prohibited by Business & Professions Code § 17500. The unlawful practices prohibited by the UCL are any practices forbidden by law, whether civil or criminal; federal, state or municipal; statutory, regulatory, or court-made. Saunders v. Superior Court (1994) 27 CA4th 832, 33 CR 438.

Remedies - The UCL statutes expressly authorize equitable relief in the form of an injunction or restitution for violations. Cel-Tech Communications, Inc. v. Los Angeles Cellular TelCo. (1999) 20 C4th 163, 83 CR2d 548. It also authorizes civil fines of up to $2,500 per violation.

Standing - The AG, local prosecutors, or individuals acting as “private attorneys general” may bring actions in the public interest.

Problems - Need multiple victims because lawsuits must be in the public interest.

c. Consumers Legal Remedies Act (Civil Code 1750 et seq.)

Theory – The Act specifies that certain methods of advertising goods or services to consumers are unfair or deceptive, and therefore unlawful, when they are intended to result in the sale/lease of goods/services to consumers (Civil Code 1770).

Remedies – Actual damages, an order enjoining such methods, acts or practices, restitution of property, punitive damages, and/or any other relief which the court deems proper may be awarded. A senior or disabled person may seek an additional $5,000 under some circumstances.

Standing – Any consumer who suffers any damage as a result of the use or employment by any person of a method, act, or practice declared unlawful by Section §1770 may bring an action.

Problems – Insurance products may not be goods or services. *Note:* this section could be amended to specifically include insurance and trusts.

d. Duty of Good Faith and Fair Dealing Owed by Insurers to Seniors (I.C. 785)

Theory – Insurers, brokers, agents, and others engaged in the transaction of insurance owe a duty of honesty, good faith, and fair dealing to all prospective insureds who are 65 years of age or older. I.C. 785(a).

Remedies – Injunctive relief, the same fines applicable in administrative actions for violations of I.C. 785 (see details below), damages, restitution, "and all other remedies in law." I.C. 789(e). The prevailing party is entitled to attorney's fees and court costs. *Note:* Individual victims may obtain restraining orders enjoining abusers "from abusing, intimidating, molesting, attacking, striking, stalking, threatening, sexually assaulting, battering, harassing, telephoning" them (W&I 15657.03).

Standing – In general, only the AG or local prosecutors can use. Individual victims do not have a right to sue, except to obtain a restraining order (see above).

Problems – Litigation is complicated, expensive and relatively rare (see discussion of the Fremont case, below). *Note:* this section could be amended to give individuals the right to sue in the public interest.

e. Restrictions on Insurance Advertising (I.C. 787)

Theory – Advertisements "designed to produce leads… from a potential insured which is directed towards persons age 65 or older shall disclose that an agent may contact the applicant if that is the fact." This section includes many more specific rules (i.e. regarding the use of a "fictitious name which is deceptive or misleading." However, those rules appear to only apply to disability insurance.

Remedies, Standing, Problems – same as for violations of I.C. 785. *Note:* this section could be amended to include other rules and all insurance products.

f. Business & Professions Code Section 17500.3(b) –

Theory – makes it unlawful for any person to solicit a sale or order for the sale of goods or services at the residence of a prospective buyer, in person or by telephone, to use any plan, scheme, or ruse which misrepresents his true status or mission for the purpose of making such sale or order for the sale of goods or services.

Remedy - The intentional violation of this section shall entitle persons bound to a contract to damages of **two times the amount of the sale price** or up to two hundred fifty dollars ($250), whichever is greater.

Standing – Victims can sue.

Problems - This section excludes any person selling any "intangibles," which probably include insurance and trusts. *Note:* this section could be amended to delete this exemption.

g. Civil Code Section 3345 – Unfair and Deceptive Practices Against Seniors – Triple Damages

Theory – An fine enhancement for deception/financial fraud victimizing of seniors

Remedy – triples any fine, civil penalty, or other remedy that would otherwise be imposed if the victims had not been seniors

Problem – Not its own cause of action.

3. *Current law - administrative regulations and remedies:*

Violation of I.C. Sections 780 or 781by an agent or broker (misrepresentation of a policy, see criminal law, above, for a more detailed description): the commissioner, after a hearing, may suspend the license of any such person for not exceeding three years. I.C. 783.

Violation of I.C. Sections 780 or 781by an insurer (misrepresentation of a policy, see criminal law, above, for a more detailed description): the commissioner, after a hearing, may suspend the insurer's certificate of authority to do the class of insurance in respect to which the violation occurred. I.C. 783.5

Violation of I.C. Sections 785 et seq by an agent or broker (see civil law, above, for a description of the offense): the commissioner, after a hearing may suspend the license of any such person for not exceeding three years and/or impose fines: ($250 minimum for the first offense; minimum of $1000 and maximum of $25,000 per violation for subsequent offenses)

Violation of I.C. Sections 785 by an insurer (see civil law, above, for a description of the offense): the commissioner, after a hearing may suspend the insurer's certificate of authority to do the class of insurance in respect to which the violation occurred and/or impose fines: (a minimum of $2,500 for the first offense; minimum of $10,000 and maximum of $100,000 per violation for insurers making a business practice of violating these provisions).

Problems - The fines are relatively low, considering the profits made. The fines are almost justifiable as a cost of doing business for scam artists who are making millions unless they are aggressively sought (on a per violation basis) Also, administrative action appears to be relatively rare.

III. Regulation: Who is responsible for protecting consumers from financial scams?

A. Federal Regulation:

Because of recent changes in federal law, there is now a great deal of cross-over between the insurance, securities, and banking industries. The Gramm-Leach-Bliley Financial Services Modernization Act of 1999 (GLBA), relaxed Depression-era rules that segregated commercial banking from investment banking.[5] "Banks now sell mutual funds, securities firms offer checking accounts and insurance companies offer products for investment."[6] While such "financial modernization" is touted as a way to streamline services for consumers, it has its draw-backs. "The integration of these three industries' marketing and other functions…has challenged the ability of regulators to oversee the financial services industry effectively."[7]

On the federal level, banking products are regulated either by the Federal Reserve or the Office of the Comptroller of the Currency, depending on the nature of the product. The Securities and Exchange Commission (SEC) regulates securities. Federal regulators generally only pursue the worst offenders who perpetrate the biggest frauds.

B. State Regulation:

California, like all states, has its own regulatory scheme independent of (and sometimes conflicting with) regulatory systems in place at the federal level and in other states. As a result, an investment product may be defined as insurance in California, as a security in another state, and as something else (or nothing at all) at the federal level.

The different and sometimes overlapping jurisdiction of state and federal regulators has left enforcement gaps that scam artists are eager to exploit. Insurance agents who are not licensed securities dealers may sell products that are considered to be securities by either the federal government or the state where the products are sold. Securities dealers and attorneys sometimes sell or market insurance products, or collaborate with insurance agents, without being licensed insurance agents themselves.

Meanwhile, state officials try to keep track of scam artists who move across state lines and change the names of their companies to evade detection. It is no wonder that consumers are often confused about where to turn for information and assistance. When consumers do contact officials, they are often given conflicting advice or told that their complaints cannot be investigated in a timely manner.

C. California - multiple regulators

1. The Department of Insurance (DOI) is responsible for regulating the $80 billion-a-year insurance industry and protecting consumers who buy insurance products. According to DOI's website (http://www.insurance.ca.gov/docs/FS-Consumer.htm), the Department "regulates, investigates and audits insurance business to ensure that companies remain solvent and meet their obligations to insurance policyholders."

2. The California Department of Corporations (DOC) regulates the sale of securities. The Department of Corporations is also responsible for "educating the public on matters relating to finance and investment."[8] The regulatory authority of DOC is limited, however, because of current California law. The law excludes variable annuities, which clearly have characteristics of securities, from the definition of securities. Furthermore, life insurance agents are exempted from the general requirement that those involved in the sale of viatical settlements be licensed securities dealers, despite the fact that they are the ones most likely to be involved in those transactions.

3. The California Department of Consumer Affairs (DCA) works to promote and protect the interests of California consumers. The department offers information to consumers about how to protect themselves, resolve disputes, and find referrals to the state and federal regulators who oversee professionals involved in their specific disputes. The DCA also licenses and regulates 2.3 million professionals, including doctors, dentists, contractors and auto-repair technicians.

4. The State Bar of California regulates the practice of law by licensed attorneys in order to ensure that all lawyers are ethical, competent and professional. Ethics rules, among other things, prohibit

attorneys from sharing their fees with non-attorneys. Consumers often contact the State Bar to complain about attorneys, other individuals who falsely hold themselves out to be attorneys or unlawfully offer legal advice. The State Bar takes disciplinary action against attorneys who aid in the unauthorized practice of law under B&P Code §6105. The State Bar refers complaints about non-attorneys to the regulatory agencies having authority over those individuals, as well as to state and local law enforcement officials having authority to prosecute violations of the law.

5. The Attorney General's Office establishes and operates projects and programs to protect Californians from fraudulent, unfair, and illegal activities that victimize consumers. In addition to other powers, the AG has the authority to sue insurers, brokers, agent and others who violate the duty of good faith that they owe to seniors under Insurance Code Section 785. The Attorney General (and local prosecutors) may sue for injunctive relief, penalties specified in Section 789.3, damages, restitution, and all other remedies in law."

6. District attorneys and city attorneys are also empowered to pursue civil and criminal litigation in this area. However, there only seem to be a handful of offices in the state that aggressively prosecute senior financial abuse cases. Even those offices find the cases they pursue to be complex and time-consuming. In Yolo County, for example, the District Attorney's Office successfully prosecuted an insurance agent (who also happened to be a disbarred attorney) who fraudulently marketed and sold annuities to more than fifteen elderly members of a local church. One of the victims was an 84 year-old woman with Alzheimer's disease. The defendant sold her an annuity to "help her" qualify for Medi-Cal, and placed her in a nursing home which he claimed accepted Medi-Cal. The woman's family subsequently found out that the home did not accept Medi-Cal and was responsible for a large fee for her care. The family urged the insurance company to rescind the annuity based upon the woman's mental condition, and her need for the money. The company agreed, but initially demanded a fee for the rescission. Ultimately, after the woman's family intervened, the insurance company agreed to waive the rescission fee.

7. Adult Protective Services (APS) is a state-mandated county service program charged with investigating situations involving elderly and dependent adults in danger due to abuse, neglect, exploitation, or hazardous or unsafe living conditions. APS social workers provide 24 hour emergency response services; mobilize emergency personnel such as paramedics or law enforcement in high risk situations; refer clients to other county and community services such as public health assessment, and counseling services; and provide many other services. APS social workers often discover cases of seniors being victimized by financial scams. In extreme cases of financial abuse, APS can file a petition for the appointment of conservators of the person and/of the estate of incompetent seniors.

D. Effectiveness of Multiple Regulators:

Ideally, the agencies and offices empowered to enforce the law in California work cooperatively to crack down on fraud and abuse. Sometimes the system works well. In April, 2002, for example, investigators with the Department of Insurance, the San Diego County District Attorney's Office and the Department of Corporations jointly announced the service of search warrants at the corporate office of a viatical settlement company. The company was suspected of fraudulently selling viatical settlement contracts that cost investors more than $2.7 million. The majority of alleged victims were senior citizens who invested their retirement funds and life savings in the viatical contracts.

In the worst cases, however, cases fall through the cracks because consumers are confused about where to turn to get help, consumers are told that there are long waiting lists for assistance, and agencies assume that other offices are addressing the problems.

IV. Trends: Several factors are likely to increase the incidence of fraud.

A. The economy:

After losing millions of dollars in the market, investors are looking for lucrative investments. The current economic slump has motivated unscrupulous individuals to capitalize on investors' desperation. At the same time, investors are vulnerable to false claims that they can make up for their market losses. The increase in both the supply of and demand for products that promise to pay high returns without risk may fuel a proliferation of fraudulent investment schemes. According to Joseph Borg, president of the North American Securities Administrators Association (NASAA)[9],

> [r]ecord-low interest rates and a bear market on Wall Street have created a bull market in fraud on Main Street…Con artists know investors are concerned about the volatile stock market and low yields on bonds and bank deposits, so they pitch their scams as safe alternatives and promise high returns – an impossible combination."[10]

B. California's current budget crisis:

California's current budget crisis could leave seniors even more vulnerable to scam artists. A key component of the budget proposal is to realign funding of local services (such as funding for Adult Protective Services (APS)) to local governments. For example, the proposal cuts $60.8 million in General Fund money now designated for APS. Squeezed by budget limitations, counties may cut back on programs to prevent, prosecute and deter elder abuse because they may be deemed to be secondary to other crucial public safety programs.

On the positive side, the Department of Justice would receive an additional $545,000 from the state's General Fund (and $1.6 million in federal funds) specifically for the purpose of the investigation of Medi-Cal fraud, elder abuse and neglect, and poor quality of care in federally funded Medi-Cal facilities, under the proposal. Also, both the DOI and DOC are specially funded departments, funded by fees and fines paid by the companies they regulate. Therefore, they are protected to some extent from budget cuts and can continue their effort to fight financial abuse.

C. Technology and information sharing:

Financial institutions currently collect and maintain enormous amounts of information about their customers. Some of the information is provided directly by customers when they apply for and use banking services and insurance products. Other data is gathered by financial institutions from transactions with their customers. Finally, data can be purchased or otherwise acquired by financial institutions from third parties, public entities and so-called "data augmentation" companies to learn more about their customers.

The data collected by insurance companies may include very sensitive medical information obtained in connection with underwriting insurance or processing claims. Bank data may include lifestyle information derived from customers' borrowing, purchasing and spending habits. A customer's credit card history, for example, can show what the customer buys, where the customer shops, how much the customer spends, and how long the customer takes to pay for his or her purchases. Securities firms have detailed data about consumers' financial portfolios and financial plans.

Some of the largest financial institutions (banks, insurance companies, securities firms and credit card companies) have acknowledged that they sell or share customer information to third-party vendors as well as their own affiliates and subsidiaries. Current federal law allows financial institutions to share the information with affiliates in an unlimited manner ("no opt-out"). It also allows financial institutions to trade or sell customer information to third parties unless customers "opt-out" of such a trading system.

Insurance agents may also have their own informal networks to share or trade their clients' financial information. Several witnesses interviewed in preparation for this hearing indicated that a network of *unethical* insurance agents currently trades customers' financial data for marketing purposes. These unethical agents repeatedly solicit the same pool of customers for sales of "new and improved" financial products, and "churn" annuities to generate commissions.

D. An aging population

Recent estimates reveal that the number of seniors age 65 and over will double in 20 years, from 3.3 million, to over 6.6 million.[11] National reports indicate that persons over 50 control at least 70 percent of the nation's household net worth. These two trends indicate the likelihood for continued growth in the number and severity of financial abuse crimes involving the elderly.

E. The proliferation of titles used by investment professionals

Consumers are more likely to trust financial and legal advisors who have credentials, than those who lack them, because they assume that credentials indicate a minimum level of regulatory oversight, as well as knowledge, training and experience on the part of the advisor. If they are seeking legal advice, it is easy for them to distinguish attorneys from non-attorneys. If they need an accountant, they can easily determine whether or not someone is a Certified Public Accountant (CPA). Likewise, they can easily determine whether an individual is a licensed insurance agent or securities broker.

In the field of financial advice, however, professionals (including individuals who have other licenses, for example to sell insurance or securities) use a myriad of titles and certifications. The names and titles used by legitimate and illegitimate investment professionals are so similar that even the most savvy consumers often cannot keep them straight. As a result, it is difficult for consumers to tell the difference between legitimate professionals and unskilled advisors who are likely to reek havoc on their legal and financial plans in their pursuit of easy profits.

The use of most titles is subject to neither federal nor state regulation. According to the AARP, "the only term currently subject to federal regulation is 'investment advisor' when the advisor handles more than $25 million."[12] Investment advisors who handle less than $25 million are subject to state regulation, and must register with the state securities agency in the state where their business is located.[13]

Other titles and designations are granted by independent organizations with their own standards and oversight, which may vary dramatically. While some may be legitimate designations of expertise, others may be marketing ploys. Organizations may conduct one or a limited number of classes in a complex subject, and then certify attendees to be experts. Consumers sometimes have the false impression that sales representatives have a superior level of education, objectivity, or expertise. As a result, critics allege that "[m]any people using titles, including "financial planner" and "personal financial consultant," are unregulated and have met with no minimum standard requirements."[14]

V. The Most Common and Costly Scams

For the past three years, the NASAA has published an annual list of "Top Ten Investment Scams." The list for 2002, compiled by the NASAA from information supplied by state securities regulators, was released in August. Three of the top ten (including the number one scam in the nation) involve insurance: unlicensed individuals, such as independent insurance agents, selling securities (number 1); viatical settlements (number 6), and charitable gift annuities (number 8). In February 2002, the NASAA warned consumers about "Risky 'death futures'," citing reports by regulators in 21 states that they had taken action on behalf of defrauded investors.[15]

Quatloos.com, a public education website (http://www.quatloos.com/default2.htm) maintained by Financial and Tax Fraud Education Associates, Inc., a California non-profit company and a §501(c)(3) tax-exempt organization, lists viaticals fraud and financial planning scams (along with tax evasion, and multi-level marketing) in the "Gallery" of its "Cyber-Museum of Scams and Frauds." Specifically, it exposes several types of "annuity abuse," the "use and abuse of living trusts," and viatical settlement fraud schemes that cost investors millions of dollars every year.

A. Annuities

Annuities can be a valuable and appropriate investment product when properly represented by qualified personnel, and when bought by suitable consumers. Annuities can help consumers to diversify their investment portfolios and to achieve other investment objectives. When sound, they are backed by the assets of a regulated insurance company, with the added buffer of a state insurance guaranty association.

However, problems do exist. In a special report published this month, Consumer's Union, in its publication Consumer Reports, warns consumers that although annuities are "selling faster than chocolates on Valentine's Day…[they] can have unsavory effects on your savings."

> To hear insurance companies, banks, and brokers tell it, annuities are about the best investment to come down the pike since Microsoft went public… Aware that their depositors will be hard put to replace the 6 percent rate long-term CDs previously paid, banks, with a quick phone call or letter, are pushing annuities, particularly to retired people and customers with maturing CDs. …Even with tax advantages, annuities are often poor investments. They come with lofty fees and stiff withdrawal penalties. Another looming problem: the shaky financial condition of some of the insurance firms that stand behind these products. If an insurer goes out of business, you could lose some of your investment.[16]

On February 24, 2003 the New York Times/Reuters advised investors that "Perhaps It's Time to Dump the Annuity."[17]

1. General Information

In general, there are two types of products referred to as annuities. An **immediate annuity** is a contract that pays an income amount periodically, e.g., monthly or annually, to the annuitant, often for life. There can be a certain payment period (i.e.10 years), so that the income will be paid for at least that long whether the annuitant lives or not. A **deferred annuity** is similar to a tax deferred savings account. It does not pay income benefits so is not really an annuity at all (so the term "annuity" should be used with caution so as not to mislead). It is called an annuity because theoretically there is a date when the deferral amount will actually be used to provide periodic income benefits. It is tax deferred in that any federal income taxes on gains during the deferral period are deferred until the money is withdrawn.

To further confuse matters, there are two types of immediate and deferred annuities: **fixed** and **variable.** A **fixed immediate annuity** pays a periodic income amount which is known at the time of issue, whereas a **variable immediate annuity** pays an income amount which can be different from one payment to the next, depending on the performance of investment. There may or may not be floor guarantees on the amount of a payment. Conceivably, then, payments under a variable immediate annuity could be something like $100 one month, nothing the next, $200 the next, etc.

A **fixed deferred annuity** credits interest to premiums paid by the policyholder at a rate declared periodically by the insurance company. Once interest is credited it cannot be lost later. There is a statutory minimum rate that serves as a guaranteed floor. A **variable deferred annuity** deposits premiums into various subaccounts (like mutual funds); the annuity's value is then equal to the value of these accounts.

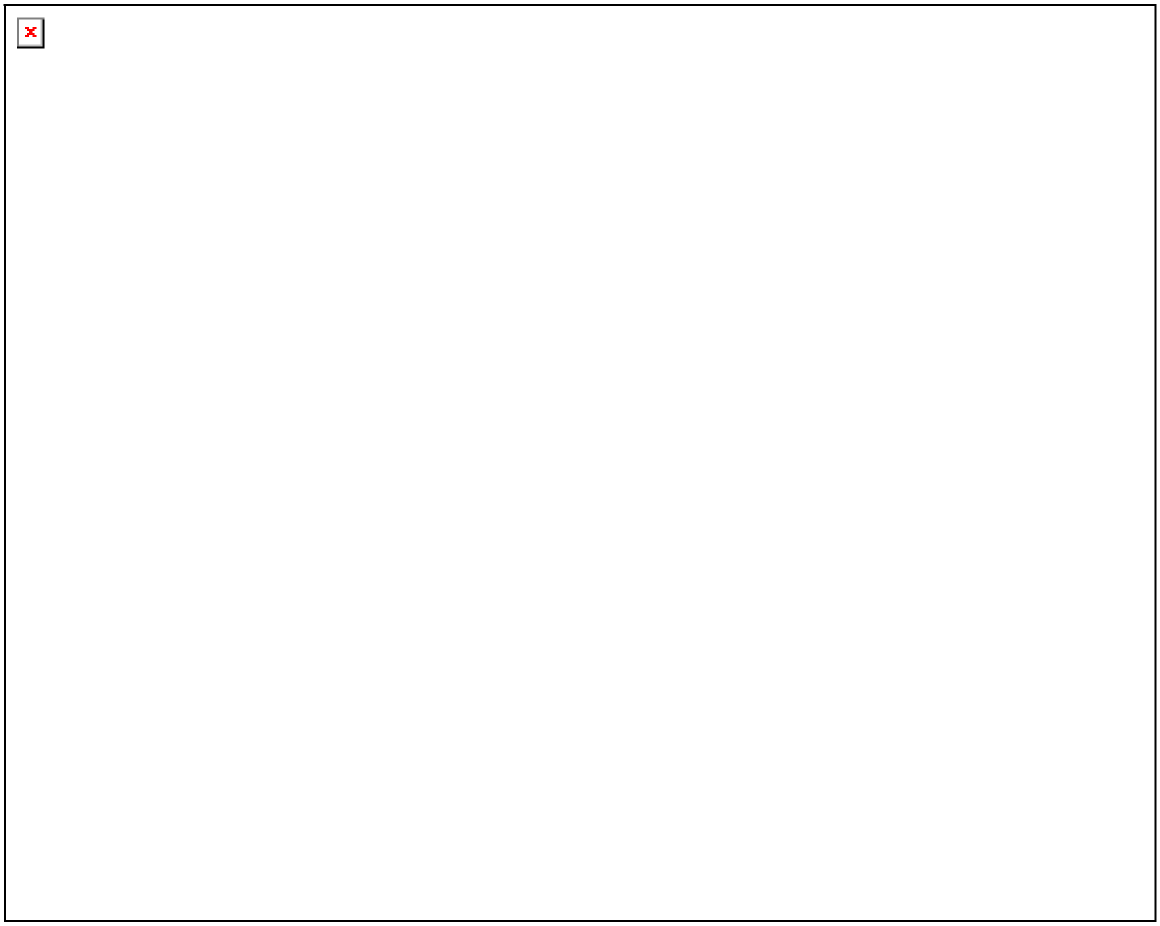
A special case of a fixed deferred annuity is called an **equity indexed annuity**. This is a deferred annuity whose account value is linked to some index, such as the S&P 500. The account is credited with some percentage of the growth in this index from the last crediting date. As with all fixed deferred annuities, there is a statutory floor. These products then give participation in the upside of the stock market with protection from downside risk.

Nationally, sales of variable annuities have increased dramatically in the past ten years. However, sales have declined recently (probably because of declining stock market returns), falling approximately 17.8% in 2001 alone.[18]

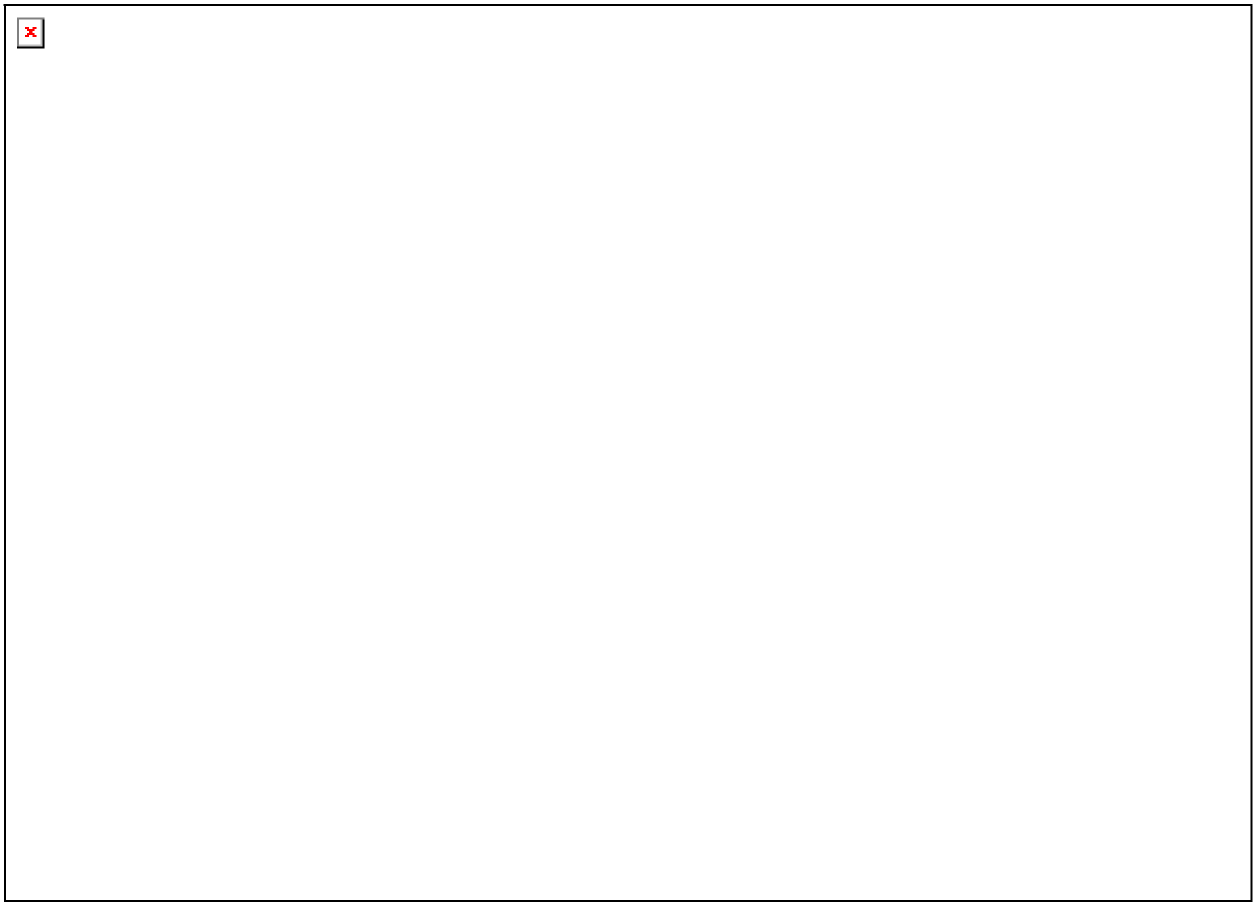
2. Demographics of buyers

Age – According to the Department of Insurance, there are no figures currently available regarding the age of annuity purchasers.

Income - The typical variable annuity purchaser has a relatively moderate household income. The following graph shows the breakdown of purchasers by household income of variable and fixed annuity sales in 1999. Surprisingly, approximately 58% of non-qualified variable annuities were purchased by consumers with relatively low household incomes (less than $50,000). Almost 80% were purchased by households with less than $75,000 in annual income. Considering that tax-deferral is probably the most important feature for this product, it would appear that those who are investing in variable contracts are already in the lower tax brackets. Furthermore, these figures may demonstrate that a significant number of these investors may be less sophisticated in terms of experience and risk tolerance than those with a higher income.



Churning? - The industry seems to be selling products to customers who already own annuities. Most new sales figures represent replacements of existing, in-force, variable annuity contracts (see chart below). In the year 2000, for example, the industry sold roughly $138 billion of variable annuity premiums. Of this amount, almost 80% represented replacement of in-force contracts. Every time a consumer purchases a replacement annuity, the consumer pays a surrender charge (for the old annuity) and a new sales commission.



3.　　Problems/Abuses:

Surrender charges
Most deferred annuities are **back-end loaded**, which means that they contain **surrender charges**. These charges are imposed if the money is withdrawn and can be substantial. They usually decrease over time but can last for many years, even 20 or more in some cases. Customers who purchase a back end loaded deferred annuity and then change their mind are essentially locked in: they cannot get their money out without paying a surrender charge. A misunderstanding of or lack of disclosure of surrender charges and the existence of "teaser rates" at issue are probably the most common elements of deferred annuities that are subject to sales abuse.

Long deferral periods
Another issue is possibly inappropriate sales of deferred annuities with surrender charges, essentially contracts designed to provide tax deferred savings for retirement, to senior citizens who are already retired and who are already in very low income tax brackets. Seniors sometimes invest their entire life savings in these types of products. They are left with no assets or income (for years). Several examples were given to the committee of elderly person (who were over 80 years old) buying deferred annuities that would not pay them any income for more than ten years. When they wanted out of the contracts, they were forced to pay surrender charges, or negotiate with insurance companies to rescind the contracts because of agent misconduct. In some cases, the contracts are only rescinded after conservatorships for the seniors are established. Even in those cases, seniors would often be charged for the cost of cancellation.

Commissions
Commissions paid for variable annuities are roughly 6% - 8% compared to those for mutual funds,

which average 2% - 6%. Furthermore, commissions are "heaped" (they are paid in the first year, rather than spread out over several years). Unlike commissions for mutual funds, there are no breakpoints; commissions aren't reduced when a larger amount is purchased.

Marketing Abuses

- *Senior Seminars* – "Financial/Estate/Tax/Retirement Planning" seminars are often held at senior centers and occasionally through church groups. Topics often include MediCal planning, long term care, "asset protection" and estate planning. Annuities are often touted as being "exempt" assets for Medi-Cal planning purposes (which is true), however it is usually not disclosed that annuities are subject to recovery for purposes of Medi-Cal reimbursement.

- *Living Trust mills* – In this particularly abusive sales situation, an attorney or paralegal holds a seminar in which seniors are sold on the use of Living Trusts. At the seminar, seniors fill out questionnaires about their assets and their concerns. Sometimes, they are even given sales contracts to sign. A paralegal or insurance agent meets the senior after the seminar (often at the senior's home) and delivers the trust to be signed. At that time, or sometimes a few days later, that same individual, or another insurance salesperson visits the senior to explain that in order to fund the new Living Trust, the senior must liquidate his or her assets and placed them all into an annuity.

- *Banks* – Bank sales of variable annuities have blossomed in the past ten years. Salespeople employed by banks work with existing clients to replace certificates of deposit with fixed and variable annuities. From 1990 to 2000, bank variable annuity sales have jumped from $0.2 billion to $15.6 billion. The difference in investment risk between certificates of deposit and variable annuities can be significant, and a number of seniors have been shocked to find that they have suffered significant losses in the past two years.

- *Other areas of concern:*
  - Variable products are being sold as "retirement plans" with little or no disclosure that the consumer is actually purchasing life insurance.
  - Undisclosed bundling of insurance – An estimated 1,000 consumers in Florida were recently the target of a scam where an unscrupulous agent informed ailing seniors that unless they paid substantially higher premiums, their Medicare supplement insurance would be canceled. The seniors had no idea that the additional premiums were purchasing life insurance policies which they did not need. One couple thought that their Medicare premiums had gone up dramatically every few months when in reality, they had purchased six life insurance contracts without their knowledge.

4. Existing protections against annuity abuse:

a. "Look-back law"

Current law gives senior citizens (aged 60 years or more) a 30-day free look-back period, during which they the right to rescind a sales contract to purchase a fixed or variable annuity. For fixed annuities, the return of the policy during the cancellation period shall "have the effect of voiding the policy from the beginning, and the parties shall be in the same position as if no policy had been issued" (I.C. Section 10127.10(a)). For variable annuities, however, "return of the contract during the cancellation period shall entitle the owner to a refund of **account value** and any policy fee paid for the policy" (I.C. Section 10127.10(a)). In other words, insurance companies are free to immediately invest the amount the senior pays for the annuity. If the senior exercises his/her option to rescind the contract, he/she may not get back the entire amount paid for the product.

b. Cap on forfeiture amount:

The Standard Non-forfeiture Law for Individual Deferred Annuities (I.C.10168 et seq.) provides for minimum nonforfeiture values by capping the amount that can be withheld from amounts paid for nonforfeiture benefits. The law allows for a maximum load of 10% for a single premium product (SPDA) while it allows for 35% for a flexible premium product, where additional premiums can be (but don't have to be) paid after issue.

Many deferred annuities are intended to be lump sum contracts where the purchaser does not plan to pay anything more into the contract after issue. However, some agents may push their clients into a flexible premium product as a good alternative in case they change their minds and want to put additional money in later. It is questionable, however, if they tell them about the possible higher load deduction which can translate into a higher commission. Even if companies are not deducting the entire 35% load when calculating nonforfeiture benefits, the nonforfeiture law as currently written allows it.

c. Special rules for replacement of life insurance and annuity policies

Under I.C. Sections 10509 – 10509.9, agents who know that an existing life insurance or annuity policy is being replaced by a new one must make certain specific disclosures to customers, and sign a form indicating that they are aware of the replacement, which must be sent to the insurer.

5. Who regulates variable annuities in California?

The California Department of Insurance regulates the sale of fixed rate annuities in California because they are insurance products. Who regulates variable annuities is a far more complicated question, however. On the federal level, variable annuities have been determined to be securities because of their nature as investment products with an inherent amount of risk. In California, however, the law seems to be muddled. The California Corporate Securities Law of 1968[19] specifically excluded annuities from the definition of "security," stating that "security" does not include "any insurance or endowment policy or annuity contract under which an insurance company admitted in this state promises to pay a sum of money (*whether or not based upon the investment performance of a segregated fund*) either in a lump sum or periodically for life or some other specified period."[20]

California case law offers little specific guidance as to the appropriate treatment of variable annuities. However, the courts have consistently held that whether or not an instrument is a security within the meaning of the CSL can be determined "only after reviewing the facts and circumstances surrounding the transactions and considering the regulatory purpose of the Corporate Securities Law,"[21] and that the courts will carefully examine the terms and conditions of each product "through form to substance"[22] in making the determination.

Interestingly, the DOI, in a consumer pamphlet published in March 2002, has stated, "If you are considering the purchase of a variable annuity, the agent should also have a license to sell variable products, *which are considered securities*."[23] Thus, the agency charged with regulating variable annuities considers them to be securities, instruments ordinarily regulated by the DOC. The bottomline: the confusion in California law about which agency is responsible for regulating variable annuities may have left the industry essentially unregulated.

6. Regulatory response

According to DOI, it pursues five to ten major senior-related insurance fraud enforcement cases each year. The department emphasizes that those cases involve multiple victims and agents. DOI also pursues many discreet cases of fraud and abuse. In those smaller scale cases, DOI works with victims and insurance companies to secure settlements for fraudulent practices by individual agents. According to Former Commissioner Harry Low, DOI identified seven "production agencies" that preyed upon seniors during Mr. Low's tenure and subjected them to regulatory and enforcement actions. As a result of DOI's interventions in those cases, more than $9.5 million was returned to seniors or their families.

Critics of the department allege that the amount recovered should have been much higher considering the number of annuities sold every year in California, the high cost of the average annuity, and the number of complaints received by the Department. For example, critics charge that DOI has been more interested in pursuing individuals for discreet cases of insurance fraud (i.e. filing fraudulent claims), than in investigating fraud by licensed insurance companies, agents, or brokers. Of the department's 159 press releases issued in 2002 about arrests or enforcement actions for fraudulent or illegal activity, 126 involved individuals, whereas 33 involved either insurance agents (or former agents), brokers, or companies.

7. Litigation:

In 1996, the Attorney General's Office sued Fremont Life Insurance Company, its parent company (Fremont General Corporation), two other insurance companies, and the Alliance of Mature Americans (AMA) for unfair competition in connection with the sale of annuity products to seniors. In the Fremont case, representatives from the Alliance of Mature Americans (AMA) telephoned and sent mass mailings to prospective clients (mostly seniors), offering free in-home consultations about living trusts. AMA representatives, who were licensed insurance agents but not attorneys, then went to the homes and identified themselves as "certified trust advisors" and presented a number of legal documents for signature, including intervivos (living) trusts, pour-over wills, and various powers of attorney. Later, they came back to the homes with completed documents and tried to persuade the residents to buy annuities.

The trial court found that the intention to sell annuities was the foremost concern of AMA agents. That goal "dwarfed everything else of value, including the consideration paid for the estate plan and the commission arising from the estate plan sale." The court held that AMA and Fremont Life had violated the unfair competition law in three different ways: by engaging in the unauthorized practice of law, by making misleading or untrue statements about the agents being estate planning advisors and from "an organization of senior citizens," and by making misleading and deceptive statements about the premium charges for the annuities.

The trial court fined Fremont Life $2.5 million in civil penalties. The trial court also issued an injunction, and required Fremont to pay restitution. Fremont appealed the ruling. In December 2002, California's Second District Court of Appeals upheld the trial court's rulings and awards. The AG's Office settled with two other insurance companies.

Although Fremont General (the parent company of Fremont Life) offered to settle the suit against them prior to trial for $2 million, the Attorney General's complaint against Fremont General was ultimately dismissed. Therefore, the Attorney General's office was ordered to pay Fremont General's costs of defending the suit (nearly $1 million).

The Fremont case illustrates the potential and the peril of policing the insurance industry in the courts. Although the AG's office ultimately prevailed against the unscrupulous agents and one company responsible for defrauding seniors, the litigation was extremely expensive, complex and time-consuming. It is worth noting that although Fremont Life sold approximately $200 million worth of annuities in the case, and agents collected nearly $20 million in commissions, wrongdoers only paid a few million dollars in fines, not a very high cost for doing business. Furthermore, according to the Attorney General's office, many of the unscrupulous agents who sold policies for AMA are **still selling insurance** in California.

[24]

8. Possible remedies for annuity abuse:

- Clarify existing law regarding the nature of variable annuities (insurance vs. securities), and thus the agency in charge of their regulation. California law would be consistent with federal law if variable annuities were classified as securities and thus salespersons were subject to licensure by the Department of Corporations.
- Restrict sales entirely above a certain age. The downside here is that there might be some cases where a deferred annuity with surrender charges can be an appropriate product for an older person to buy.
- Require full return of premium at any time to purchasers above a certain age who purchase deferred annuities with a deferral period of a certain time. The downside here is that without surrender charges companies will not be able to pay attractive commissions, which will likely result in agents not selling these products. Thus, a return of premium provision requirement could be tantamount to disallowing sales in the first place. Another possible downside is that a company might pay the commission but cover the risk of early surrender by investing shorter and therefore give a lower return.
- Limit the ability of insurers to invest the amount paid by a senior for a variable annuity until the look-back period (currently 30 days pursuant to I.C. Section 10127.10(a)) has elapsed.
- Increase penalties (including fines and recoverable damages) for violations of EADACPA
- Enact suitability guidelines, forms, and/or disclosures
- Regulate/prohibit the use of fictitious titles in the sales/marketing of annuity products
- Regulate more closely the advertisement/marketing of annuities
- Ensure that DOI has the authority to collect data on the life insurance and annuity marketplace

B. Charitable Gift Annuities:

1. General Information:

A Charitable Gift Annuity (CGA) is a contract between a public charity and a donor. The donor makes a gift (usually of highly appreciated assets such as stocks, mutual funds, or real estate) to the charity in exchange for a written promise of lifetime income. This promise is backed by the general assets of the charity. The income to the donor can be paid out in annual, quarterly, and monthly installments, and can be structured to be paid for one lifetime or two. The amount of income is calculated by taking into account the actuarial life expectancy(s) of the donor(s), the current Section 7520 rate (determined monthly by the IRS), and a reasonable rate of return based on current economic conditions. Almost all charities rely on the rates provided by the American Council on Gift Annuities (www.acga-web.org), who review their assumptions and calculations on an annual basis.

The primary motivation for a donor setting up a CGA is charitable intent. When the ACGA calculates the lifetime income factor, they assume that the charity will receive 50% of the original donation, and that the remaining 50% will be passed to the donor as income. If lifetime income were the only concern, the investor would be better off purchasing an immediate annuity from an insurance company. There are some tax benefits, however, available when a donor establishes a CGA. To encourage these gifts, Congress has allowed the donor to defer capital gains taxes on the highly appreciated assets used to fund a CGA and to receive a current charitable deduction for the percentage of the gift that is not returned as income.

For example, "Mrs. Wallace" is a 77 year old retired teacher who would like to make a gift to charity but is also concerned about earning income to supplement her retirement plan. On January 1, 2003, she decides to establish a $30,000 CGA with the American Cancer Society. The Society follows the ACGA recommended rate schedule and they pay her a quarterly annuity of $570 for her lifetime. She also receives a current charitable tax deduction of $12,700 (the present value of the amount that passes to charity.) Part of her quarterly income is considered a return of principal, part is tax at capital gains rates, and part is subject to ordinary income taxes.

The CGA[25] is the most common life income plan offered by non-profit organizations. Most mid-size and large charities either have such programs in place or are considering implementing a program in the near future. While the underlying concept has changed little since the 14th century, there are modern variations that make this planning technique more flexible for donors. A CGA can pay out income for one life or two, income can start immediately or be deferred, and in some states, universities have set up tuition CGAs to help parents and grandparents fund future college costs.

2. *Demographics/Key Facts:*[26]

- The average gift annuity investment is $30,000.
- An estimated 85% of CGA investors are age 75 or older.
- 60% of annuitants are female.
- 92% of all CGAs have income start immediately.
- Most charities have a minimum required investment of roughly $5,000 and, in many cases, the donors decide later to forego any future income, so that the remaining account balance simply passes to the charity prior to the donor's death.

3. *Regulation of CGAs:*

CGAs are almost exclusively regulated at the state level.[27] Federal law does include some key rules regarding CGA's. For example, charities must supply a Gift Annuity Disclosure Statement to all annuitants in Fund and to all prospective donors prior to their making their first annuity gift. This is separate from state mandated disclosure language required in gift annuity agreements of some (presently 25) states.

Federal law (15 USC 78C) also carves out an exemption for charities from the Broker Dealer provisions in the Securities Exchange Act of 1934, provided that no commissions are paid for the sale of gift annuities. Thus, if a charity pays commissions for the sale of gift annuities, the charity may be subject to broker/dealer registration under the Securities Exchange Act of 1934.

Level of Regulation	Number of States
Require a permit and regulate CGAs	10 (includes CA)
Conditional exemption from regulation	25
Provide blanket exemption from regulation	9
Are silent on the issue	7 (includes DC)

The state laws which govern California gift annuities are extremely restrictive and somewhat outdated, and most charities have generally chosen not to offer such programs to their California donors. Other less reputable charities are simply ignoring the licensing and reporting requirements and are marketing openly to these donors without following state laws. As of March 15, 2000, only 306 were licensed to offer CGAs to California residents.

4. What are the Abuses?

The vast majority of CGA contracts in the nation are in compliance with applicable laws and the charities take great pains to both inform donors of all of the required disclosures, and ensure that the contract is suitable for the donor's needs and objectives. The abuses that are occurring come from only a few charities are tend to fall into two categories: non-compliance with state laws, and paying commissions for the sale of CGA's.

Some advocates argue that the current registration and investment restrictions on gift annuity programs in California are so strict, that only a handful of charities bother getting licenses (306 as of the most recent published list on the CDI website). Many charities either ignore the current rules or are unaware of them. Since the laws as written do contain key consumer protection language, this widespread disregard for the laws is resulting in senior financial abuse and fraud.

A small handful of charities are currently paying approximately 6% to 8% in commission plus trailing fees to insurance agents to "sell" their CGA contracts (which makes them dealers/brokers under federal law) although the agents are not registered securities dealers or brokers, as required by federal law. In 1998, both the National Committee on Planned Giving (NCPG) and the American Council on Gift Annuities (ACGA) released strongly worded position papers warning their members about the practice of paying commissions for the sale of CGAs. This position was reaffirmed in 2001 by both organizations. Such practices make the entire charity industry look bad.

- *Insurance Company or Charity? Consumer Confusion:* A few charities offer programs labeled as "tax-deductible annuities" (TDAs) rather than charitable gift annuities (CGAs), and openly market that they offer payout rates that are higher than the recommended ACGA. Consumers are often confused by the terminology of what they are purchasing (many don't understand that this is not a commercial annuity backed by the assets of a regulated insurance company and with the added buffer of the state insurance guaranty association). This is further confused by the names of the charities offering these products which may lead consumers to believe that they are purchasing insurance products. (For example, the largest seller of TDAs in California is New Life Corporation, based out of Tennessee.)

- ***Suitability:*** Seniors who are investing in these tax-deductible annuity programs may be placing a much higher percentage of their savings than they would with a non-commissioned CGA charity. For example, the average CGA investment is currently $30,000 according to a recent ACGA survey. The average TDA sold through New Life Corp is $140,000, according to a recent advertisement. The high commissions are resulting in inappropriate sales to CA seniors.

- *Financial Viability of the Charity:* In the late 1990s, three primary charities were offering CGAs in California for commissions (even though none of the three were actually licensed with the state.) Two of the charities (Mid-America Foundation and New Life Corp) jointly marketed their products and conducted numerous insurance agent recruiting sessions throughout the state. In October 2001, Mid-America Foundation boasted a net worth of $54 million. Only two weeks later, Mid-America declared bankruptcy and the head of the charity disappeared. As it turned out, the charity CEO had embezzled and squandered the funds and literally thousands of seniors were left without their retirement income. New Life Corp has invested a substantial part of their annuity reserves in commercial real estate, ostrich farms, and even a corporate jet for the use of the charity executives. In another case, a group of financial advisors in Arizona created a charity just for the purpose of selling CGAs. The charity paid the advisors between 19% and 52% commissions for the sale of CGAs and the charity collapsed in November 2002.

5. What Actions Are the Regulators Taking?

After Mid-America Foundation declared bankruptcy in 2001, the SEC filed fraud charges against the charity executive for running a Ponzi scheme. The Arizona Corporations Commission has taken action against both Mid-America Foundation and One Vision Children's Foundation, which collapsed in November 2002.

According to an expert on the subject, the only action taken in California on any charitable gift annuity program was a Cease and Desist letter two years ago that informed a charity that they needed to apply for a permit with the state. The California Department of Insurance website has no information at all for consumers or advisors on gift annuities. While the DOI website does maintain a list of charities permitted to offer annuities in the state, there is no link to the list, and it has not been updated in almost three years.

The AG's website has considerable information on charities but no warnings or information about charitable gift annuity programs. The DOC, likewise, appears to have no information for consumer and advisors on these programs.

6. Possible Reforms:

Amend Investment Restrictions: Only 306 charities have obtained permits to offer CGAs in California because the rules are outdated and unnecessarily restrictive. State Legislators should consider adopting one of the two NAIC Model Acts addressing Charitable Gift Annuities. This would place investment restrictions and reserve requirements for gift annuities on par with the requirements on life insurers who offer commercial annuities.

Reduce Application Fees: The application fee for obtaining a gift annuity Certificate of Authority is currently $3,272. While this may not be large amount for an insurance company, it is a very steep price for a charity. If the above investment restrictions are amended, admitting 5,000 charities to the California marketplace at $500 per charity would actually raise considerable revenue for the state, even though the fee per charity would be significantly reduced. Note: California requires its DOI fees to match expenses. Simply reducing the fee wouldn't be possible unless the net revenue still supported this DOI function.

Prohibit the Payment of Sales Commissions: Most, if not all, of the recent news stories surrounding gift annuity abuse involved organizations that were paying commissions to insurance agents for the "sale" of these fundraising tools. The major charity associations have voiced strong warnings about such practices.

Increase Enforcement: Complaints should be handled quickly and efficiently. The average age of the CGA investor is 77 and when a charity collapses, the elderly investor loses a portion of their income.

Increase Penalties: Charities in California which have consistently obeyed the laws by obtaining a permit and meeting strict investment and reserve requirements have essentially volunteered to be non-competitive. Many other charities have ignored state laws and there have been no apparent consequences to date other than one Cease and Desist letter.

*Increase Public Awareness**:*** The DOI and DOC, and the AG should all consider increasing their consumer protection education materials on their website and work with appropriate associations and senior organizations to better educate the elderly about scams. Seniors should be able to visit the DOI website to verify that their charity is licensed in the state. Consumer booklets and materials should be made available warning investors that they should carefully research the financial condition of a charity before investing in a gift annuity.

C. Viatical Settlements:

1. What are they?

In a typical transaction, a terminally ill person holding a life insurance policy sells the policy to a third party "broker" in return for a portion (usually 60 – 70%) of the death benefit. The broker then sells shares of policies to investors who theoretically recover the full death benefit when the insured person dies. Investors are essentially wagering that the terminally ill person will die as soon as possible. While the concept of the industry, which began approximately ten years ago in conjunction with the AIDS crisis, may have legitimate goals – to give terminally ill individuals much needed cash – fraud associated with the industry is a problem.

2. Regulation:

Viatical settlements are unregulated at the federal level. In California, they are regulated by both the DOI and the DOC (the original insurance policy is regulated as insurance; the shares of policies which are sold to third parties as investments are regulated as securities).

California law requires that anyone entering into or soliciting a viatical settlement be licensed by the Insurance Commissioner (I.C. 10113.1 and 10113.2). This licensure requirement applies to: (1) purchasers of the policy, (2) those who are assigned an ownership interest in the policy, including a collateral ownership interest; (3) brokers who assist the terminally ill in securing the best offer for their policy, (4) brokers who secure investors or purchasers for the policy; and (5) and those who purchase the policy after it has been purchased from the policyholder.

According to the Department of Insurance, many agents and brokers *do not know that a viatical settlement license is required for all of these transactions*, resulting in widespread noncompliance with the licensure requirements. Also secondary sales (after sale of original policy from the holder) are a problem. Producers may not know that California law requires them to have viatical settlement sales licenses. At the same time (probably not coincidentally), the number of consumer complaints to DOI is increasing.

One source of confusion may be the fact that DOC exempts certain individuals who sell viaticals from security licensure requirements, including life insurance agents. Consequently, life insurance agents and brokers may believe that they are also exempt from DOI license requirements.

3. Common Problems/Issues/Abuses:

According to a warning issued by DOI to agents and brokers, a "number of risks are involved in selling investments in viatical settlements: no insurance policy may actually exist; the terminally ill person may disappear or live longer than expected, or than was fraudulently projected; the policy may lapse because the premiums are not paid; or a contestable policy may be contested by the insurance company."[28] Of course, those risks also apply to investors.

There may also be risks to those who sell their life insurance policies. According to DOI, there have been a number of complaints recently from individuals who sold their life insurance polices to insurance agents or companies. The agents or companies then resold the policies to unknown (in most cases, unlicensed) individuals who begin to contact them, "checking out their investment" (whether or not the formerly insured person has died).

4. Regulatory responses:

Former Insurance Commissioner Harry Low issued several consumer alerts regarding viatical settlements. The DOC has started a massive training effort for a new statewide program called Seniors Against Investment Fraud (SAIF). The $1.2 million program aims to educate people 50 and older about how to avoid being swindled by unscrupulous telemarketers, unscrupulous stockbrokers, and unethical financial planners. The effort will fund a public education campaign to include informational meetings at seniors communities, mailings, public service announcements and billboards that show a large target painted around the face of an older person talking on the telephone.

5. Possible Remedies:

- Include all settlements, "life settlements", "viatical settlements", and "senior settlements" within DOI's jurisdiction.
- Require all individuals who sell or resell (in primary and secondary sales) viatical settlements to also be licensed security dealers, subject to DOC regulation.
- Create a consumer private right of action for .
- Clarify existing law so that life agents selling settlements are required to obtain a separate viatical settlement license.

VI. Conclusion

California regulators are taking steps to protect seniors from financial abuse, and to crack down on scam artists who victimize seniors. However, more must be done.

There are many strong laws in place in California, but tough consumer laws have not stopped the abuse. Litigation and prosecution in this subject area has proved to be expensive, time-consuming, complex, and not always effective. Legal action, however, certainly is an important tool for consumers. Clarification and unification of the codes, all other things being equal, would tend to increase the effectiveness of both regulatory authority and litigation.

California's current potpourri of regulatory oversight may leave many bad actors unsupervised and undeterred. State agencies may be relying too much on what others are supposed to be doing – and leaving seniors and other consumers unprotected. It might be said that there are too many cooks in California's regulatory kitchen. Regulatory responsibilities should be clarified and tools should be strengthened

As California ages, and as retirement planning and eventual incomes become more and more subject to fluctuations in the stock market, Californians will turn increasingly to insurance products to diversify their portfolios. California cannot expect its seniors to become experts in arcane insurance terminology, and to have a rolodex of government numbers at their fingertips when problems occur.

In addition, insurance markets function best to meet the needs of consumers when consumers are empowered by information and common rules governing similar products. The state's budget, already stressed by the costs of Medi-Cal and long-term care for the elderly, may be at grave risk if California's seniors are unwittingly victimized by financial scams that leave their actual cash-flow negligible. Both for consumer protection reasons, and for reasons related to sound public finance, California's laws should be simplified and the effectiveness of regulatory oversight enhanced. Absent changes to the statutes, fraud is more likely to occur and the public, in all its constituent groups, further victimized. Consolidation and clarification of the law to protect Californians from financial scams would be an investment in California's future.

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[1] AARP, The Policy Book: AARP Public Policies 2002; 12-36; http://www.aarp.org/ppa/ch12.pdf.

[2] AARP, at 12-31, 12-36.

[3] See Assembly Public Safety Committee Analysis of SB 2199 (Lockyer, 1999), citing California Department of Social Services, Elder and Dependent Adult Abuse and Adult Protective Services in California: Annual Statistical Report , 1996; United States General Accounting Office, Elder Abuse: Effectiveness of Reporting Laws and Other Factors . April 1991.

[4] Journal of the American Medical Association (JAMA), August 5, 1998; Volume 280, Page 428.

[5] For an excellent discussion of how Gramm-Leach-Bliley has affected federal oversight of the banking and securities industries (and therefore, consumers), see AARP, The Policy Book: AARP Public Policies 2002; 12-7 to 12-12.

[6] AARP, at 12-7.

[7] AARP, at 12-7.

[8] http://www.corp.ca.gov/adm/opa.htm

[9] The North American Securities Administration Association is the oldest international organization devoted to investor protection. In the U.S., NASAA is the national voice of the 50 state securities agencies responsible for investor protection and the efficient functioning of the capital markets at the grassroots level. According their website (http://www.nasaa.org),

> "The NASAA Government Affairs department actively promotes the interests of state securities regulators before the U.S. Senate and House of Representatives. The NASAA staff and members monitor pending legislation, provide

information, and work with lawmakers and staff to draft legislative language to enhance investor protection at the state level. NASAA is the national advocate for ensuring state securities regulators maintain authority essential to keep this nation's capital markets safe for all investors. NASAA members have testified before Congress on a variety of initiatives and have been the voice of reasonable and responsible regulation to protect investors in our securities markets."

The NASAA regularly publishes information alerting consumers, businesses and regulators to common scams in the securities industry.

[10]
NASAA Press Release August 26, 2002, "Top Ten Investment Scams Listed by State Securities Regulators."

[11]
U.S. Census Bureau estimate, based upon the 2000 census.

[12]
AARP, 12-34.

[13]
AARP, 12-34.

[14]
AARP, 12-34.

[15]
NASAA Press Release February 26, 2002.

[16]
"Special Report: Should You Buy an Annuity Now?" Consumer Reports, February 2003.

[17]
http://www.nytimes.com/reuters/business/business-column-finance.html

[18]
JJ MacNab, March 15, 2002 presentation to the NASAA Roundtable Forum, *"Functional Regulation in the 21st Century: What's Reasonable for Investor Protection and for Agents Selling Variable Products?"*

[19]
California Corporations Code sections 25000-25706.

[20]
California Corporations Code section 25019(3), emphasis added.

[21]
Moreland v. Department of Corporations (1987) 194 Cal.App.3d 506, 512.

[22]
Silver Hills Country Club v. Sobieski (1961) 55 Cal.2d 811, 814; Sarmento v. Arbax Packing Co. (1964) 231 Cal.App.2d 421, 424; see also Moreland v. Department of Corporations, *supra*, 194 Cal.App.3d at 512, "the substance of the transaction rather than its form governs whether a transaction will be considered a 'security.'"

[23]
State of California, Department of Insurance, *Annuities March 2002*, www.insurance.ca.gov/docs/FS-Brochures.htm, emphasis added.

[24]
The Life and Health Actuarial Task Force of the National Association of Insurance Commissioners is currently studying the issue of annuity nonforfeiture with the intent of introducing a new model law. One of the proposed changes is to eliminate the high loading of FPDAs and limit all deferred annuities, single premium or flexible premium, to the same maximum loading percentage. Although no special provisions are contemplated regarding additional guarantees to seniors, the American Academy of Actuaries has agreed to study current annuity disclosure requirements and consider ways to improve them.

[25]
Defined in IRC § 501(m)(5)

[26]
Data from 1999 ACGA survey.

[27] Charities are required to report to the IRS for their tax-exempt status, and to the State Attorney General for general oversight.

[28] DOI alert @ http://www.insurance.ca.gov/docs/FS-News.htm