STATE OF FLORIDA
DIVISION OF ADMINISTRATIVE HEARINGS

DEPARTMENT OF FINANCIAL SERVICES, OFFICE OF FINANCIAL INSTITUTIONS AND SECURITIES REGULATION,

Petitioner,

vs. Case No. 02-3582

JAMES A. TORCHIA,

Respondent.

DEPARTMENT OF FINANCIAL SERVICES, OFFICE OF FINANCIAL INSTITUTIONS AND SECURITIES REGULATION,

Petitioner,

vs. Case No. 02-3583

EMPIRE INSURANCE, INC., and JAMES A. TORCHIA,

Respondents.

RECOMMENDED ORDER

Robert E. Meale, Administrative Law Judge of the Division of Administrative Hearings, conducted the final hearing in Fort Lauderdale, Florida, on February 11-12, 2003.

APPEARANCES

For Petitioner: Fred H. Wilsen
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For Respondents: Barry S. Mittelberg
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STATEMENT OF THE ISSUES

The issues are whether Respondents offered and sold securities in Florida, in violation of the registration requirements of Section 517.07(1), Florida Statutes; offered and sold securities in Florida while Respondents were unregistered, in violation of Section 517.12(1), Florida Statutes; or committed fraud in the offer, sale, or purchase of securities in Florida, in violation of Section 517.301(1)(a), Florida Statutes. If so, an additional issue is the penalty to be imposed.

PRELIMINARY STATEMENT

By Administrative Complaint for Entry of Final Order to Cease and Desist, Impose Penalties, and Notice of Rights filed October 29, 2001, Petitioner alleged that, from March 21, 1998, through July 21, 1999, Respondent Torchia offered and sold unregistered securities issued by American Benefits Services,

Inc. The securities were allegedly in the form of investment contracts that were interests in viaticated life insurance policies and settlement agreements. Petitioner alleged that Respondent Torchia was at no time licensed in Florida as a broker/dealer, registered representative, or investment advisor.

Petitioner alleged that Respondent Torchia sold these securities to 45 Florida investors in 65 transactions representing $1,757,070.88. Petitioner alleged that Respondent Torchia represented to investors that their investment return would be either 9.86 percent annually for three years, paid monthly (Income Program), or 42 percent at the end of three years, but no less than 15 percent at the end of three years, regardless whether the insured died (Growth Program).

Respondent Torchia allegedly knew or should have known that his representations were false when made because he knew or should have known that the viaticated life insurance policies did not exist, and any payments to investors were from the investors' funds or sources other than the insurance proceeds. Lastly, Petitioner alleges that Respondent Torchia knew or should have known that he was engaged in the sale of securities.

The Administrative Complaint alleges that Respondent Torchia thus violated Section 517.07(1) and (2), Florida Statutes, which prohibit the sale or offer for sale of unregistered nonexempt securities; Section 517.12(1), Florida

Statutes, which prohibits unregistered persons from selling or offering for sale any securities as a dealer, associated person, or issuer; Section 517.301(1), Florida Statutes, which prohibits fraud, misstatement or nondisclosure of material fact, or deceit in the sale, offer for sale, or purchase of any security.

Count One of the Administrative Complaint alleges that Respondent is guilty of 65 counts of having offered and sold unregistered securities in Florida, in violation of Section 517.07, Florida Statutes. Count Two of the Administrative Complaint alleges that Respondent is guilty of 65 counts of having offered and sold unregistered securities while Respondent was not registered in the securities business, in violation of Section 517.12, Florida Statutes. Count Three alleges that Respondent is guilty of 65 counts of engaging in fraud in the offer and sale of securities, in violation of Section 517.301, Florida Statutes. This Administrative Complaint commenced DOAH Case No. 02-3582.

By Administrative Complaint for Entry of Final Order to Cease and Desist, Impose Penalties, and Notice of Rights filed October 29, 2001, Petitioner alleged that, from April 22, 1997, through March 22, 1999, Respondents Torchia and Empire Insurance offered and sold unregistered securities issued by American Benefits Services, Inc. Petitioner alleged that Respondent Torchia was an officer, owner, operator, and controlling person

of Respondent Empire Insurance. Petitioner alleged that neither Respondent was licensed as a broker/dealer or investment advisor and that Respondent Empire Insurance was not licensed with the Department of Insurance as a general agency. Petitioner alleged that Respondents sold these securities to 18 Florida residents in 38 transactions representing $1,147,973.32. The remainder of the allegations are the same as those set forth in the above-described case, except that each of the three counts alleges 262 separate counts for the violation of each of the three cited statutes. The Administrative Complaint against both Respondents commenced DOAH Case No. 02-3583.

At the hearing, Petitioner called eight witnesses and offered into evidence six exhibits, which were all admitted. Respondent called three witnesses and offered no exhibits into evidence.

The court reporter filed the transcript on February 25, 2003. The parties filed their proposed recommended orders by April 30, 2003.

FINDINGS OF FACT

1. At all material times, Respondent James A. Torchia (Respondent) held a valid life and health insurance license. Respondent was the president and owner of Respondent Empire Insurance, Inc. (Empire Insurance), a now-dissolved Florida

corporation. Empire Insurance was in the insurance business, and Respondent was its sole registered insurance agent.

2. At no material time has Respondent or Empire Insurance held any license or registration to engage in the sale or offer for sale of securities in Florida. At no material time were the investments described below sold and offered for sale by Respondent or Empire Insurance registered as securities in Florida.

3. These cases involve viaticated life insurance policies. A life insurance policy is viaticated when the policy owner, also known as the viator, enters into a viatical settlement agreement. Under the agreement, the viator sells the policy and death benefits to the purchaser for an amount less than the death benefit--the closer the viator is perceived to be to death, the greater the discount from the face amount of the death benefit.

4. The viatical industry emerged to provide dying insureds, prior to death, a means by which to sell their life insurance policies to obtain cash to enjoy during their remaining lives. As this industry matured, brokers and dealers, respectively, arranged for the sale of, and bought and resold, life insurance policies of dying insureds. Prior to the death of the viator, these viaticated life insurance policies, or

interests in such policies, may be sold and resold several times.

5. In these cases, viators sold their life insurance policies to Financial Federated Title & Trust, Inc. (FinFed). Having raised money from investors, American Benefit Services (ABS) then paid FinFed, which assigned viaticated policies, or interests in the policies, to various trusts. The trusts held the legal title to the policies, and the trust beneficiaries, who are the investors from whom ABS had obtained the funds to pay FinFed, held equitable title to the policies. Sometimes in these cases, a broker or dealer, such as William Page and Associates, intervened between the viator and FinFed.

6. At some point, though, ABS obtained money from investors to acquire policies, but did not pay the money to FinFed to purchase viaticated life insurance policies. The FinFed and ABS investment program eventually became a Ponzi scheme, in which investor payouts were derived largely, if not exclusively, from the investments of other investors.

7. ABS typically acquired funds through the promotional efforts of insurance agents, such as Respondent and Empire Insurance. Using literature provided by ABS, these agents often sold these investments to insurance clients. As was typical, Respondent and Empire Insurance advertised the types of claims

described below by publishing large display ads that ran in Florida newspapers.

8. Among the ABS literature is a Participation Disclosure (Disclosure), which describes the investment. The Disclosure addresses the investor as a "Participant" and the investment as a "Participation." The Disclosure contains a Participation Agreement (Agreement), which provides that the parties agree to the Disclosure and states whether the investor has chosen the Growth Plan or Income Plan, which are described below; a Disbursement Letter of Instruction, which is described below; and a Letter of Instruction to Trust, which is described below. The agent obtains the investor's signature to all three of these documents when the investor delivers his check, payable to the escrow agent, to purchase the investment.

9. The Disclosure states that the investments offer a “High Return”: “Guaranteed Return on Participation 42% at Maturity.” The Disclosure adds that the investments are “Low Risk”: “Secured by a Guaranteed Insurance Industry Receivable”; “Secured by $300,000 State Insurance Guarantee Fund”; “Short Term Participation (Maturity Expectation 36 Months)”; “Principal Liquid After One Year With No Surrender Charge”; “State Regulated Participation”; “All Transactions By Independent Trust & Escrow Agents”; and “*If policy fails to mature at 36 months,*

participant may elect full return of principal <u>plus 15% simple interest</u>.”

10. The Disclosure describes two alternative investments: the Growth Plan and Income Plan. For the Growth Plan, the Disclosure states: “At maturity, Participant receives principal plus 42%, creating maximum growth of funds.” For the Income Plan, the Disclosure states: “If income is desired, participation can be structured with monthly income plans.”

11. Different rates of return for the Growth and Income plans are set forth below. For investors choosing the Income Plan, ABS applied only 70 percent of the investment to the purchase of viaticated life insurance policies. ABS reserved the remaining 30 percent as the source of money to "repay" the investor the income that he was due to receive under the Income Plan, which, as noted below, paid a total yield of 29.6 percent over three years.

12. The Disclosure states that ABS places all investor funds in attorneys’ trust accounts, pursuant to arrangements with two “bonded and insured” “financial escrow agents.” At another point in the document, the Disclosure states that the investor funds are deposited “directly” with a “financial escrow agent,” pursuant to the participant’s Disbursement Letter of Instruction.

13. The Disbursement Letter of Instruction identifies a Florida attorney as the "financial escrow agent," who receives the investor's funds and disburses them, "to the order of [FinFed) or to the source of the [viaticated insurance] benefits and/or its designees." This disbursement takes place only after the attorney receives "[a] copy of the irrevocable, absolute assignment, executed in favor of Participant and recorded with the trust account as indicated on the assignment of [viaticated insurance] benefits, and setting out the ownership percentage of said [viaticated insurance] benefits"; a "medical overview" of the insured indicative of not more than 36 months' life expectancy; confirmation that the policy is in full force and effect and has been in force beyond the period during which the insurer may contest coverage; and a copy of the shipping airbill confirming that the assignment was sent to the investor.

14. The Disclosure states that the investor will direct a trust company to establish a trust, or a fractional interest in a trust, in the name of the investor. When the life insurance policy matures on the death of the viator, the insurer pays the death benefits to the trust company, which pays these proceeds to the investor, in accordance with his interest in the trust.

15. Accordingly, the Letter of Instruction to Trust directs FinFed, as the trust company, to establish a trust, or a fractional interest in a trust, in the name of the investor.

The Letter of Instruction to Trust provides that the viaticated insurance benefits obtained with the investor's investment shall be assigned to this trust, and, at maturity, FinFed shall pay the investor a specified sum upon the death of the viator and the trustee's receipt of the death benefit from the insurer.

16. The Disclosure provides that, at anytime from 12 to 36 months after the execution of the Disclosure, the investor has the option to request ABS to return his investment, without interest. At 36 months, if the viator has not yet died, the investor has the right to receive the return of his investment, plus 15 percent (five percent annually).

17. The Disclosure states that ABS will pay all costs and fees to maintain the policy and that all policies are based on a life expectancy for the viator of no more than 36 months. Also, the Disclosure assures that ABS will invest only in policies that are issued by insurers that are rated "A" or better by A.M. Best "at the time that the Participant's deposit is confirmed." The Disclosure mentions that the trust company will name the investor as an irrevocable assignee of the policy benefits.

18. The irrevocable assignment of policy benefits mentioned in the Disclosure and the Disbursement Letter of Instruction is an anomaly because it does not conform to the documentary scheme described above. After the investor pays the

escrow agent and executes the documents described above, FinFed executes the "Irrevocable Absolute Assignment of Viaticated Insurance Benefits." This assignment is from the trustee, as grantor, to the investor, as grantee, and applies to a specified percentage of a specific life insurance policy, whose death benefit is disclosed on the assignment. The assignment includes the "right to receive any viaticated insurance benefit payable under the Trusts [sic] guaranteed receivables of assigned viaticated insurance benefits from the noted insurance company; [and the] right to assign any and all rights received under this Trust irrevocable absolute assignment."

19. On its face, the assignment assigns the trust corpus--i.e., the insurance policy or an interest in an insurance policy--to the trust beneficiary. Doing so would dissolve the trust and defeat the purpose of the other documents, which provide for the trust to hold the policy and, upon the death of the viator, to pay the policy proceeds in accordance with the interests of the trust beneficiaries.

20. The assignment bears an ornate border and the corporate seal of FinFed. Probably, FinFed intended the assignment to impress the investors with the "reality" of their investment, as the decorated intangible of an "irrevocable" interest in an actual insurance policy may seem more impressive than the unadorned intangible of a beneficial interest in a

trust that holds an insurance policy. Or possibly, the FinFed/ABS principals and professionals elected not to invest much time or effort in the details of the transactional documentation of a Ponzi scheme. What was true then is truer now.

21. Obviously, in those cases in which no policy existed, the investor paid his money before any policy had been selected for him. However, this appears to have been the process contemplated by the ABS literature, even in those cases in which a policy did exist.

22. The Disbursement Letter of Instruction and correspondence from Respondent, Empire Insurance, or Empire Financial Consultant to ABS reveal that FinFed did not assign a policy, or part of a policy, to an investor until after the investor paid for his investment and signed the closing documents. In some cases, Respondent or Empire Insurance requested ABS to obtain for an investor a policy whose insured had special characteristics or a investment plan with a maturity shorter than 36 months.

23. FinFed and ABS undertook other tasks after the investor paid for his investment and signed the closing documents. In addition to matching a viator with an investor, based on the investor's expressed investment objectives, FinFed paid the premiums on the viaticated policies until the viator

died and checked on the health of the viator. Also, if the viator did not die within three years and the investor elected to obtain a return of his investment, plus 15 percent, ABS, as a broker, resold the investor's investment to generate the 15 percent return that had been guaranteed to the investor. Similarly, ABS would sell the investment of investors who wanted their money back prior to three years.

24. The escrow agent also assumed an important duty--in retrospect, the most important duty--after the investor paid for his investment and signed the closing documents; the escrow agent was to verify the existence of the viaticated policy.

25. Respondent and Empire Insurance sold beneficial interests in trusts holding viaticated life insurance policies in 50 separate transactions. These investors invested a total of $1.5 million, nearly all of which has been lost. Respondent and Empire Insurance earned commissions of about $120,000 on these sales.

26. Petitioner proved that Respondent and Empire Insurance made the following sales. Net worths appear for those investors for whom Respondent recorded net worths; for most, he just wrote "sufficient" on the form. Unless otherwise indicated, the yield was 42 percent for the Growth Plan. In all cases, investors paid money for their investments. In all cases, FinFed and ABS

assigned parts of policies to the trusts, even of investors investing relatively large amounts.

27. On March 21, 1998, Phillip A. Allan, a Florida resident, paid $69,247.53 for the Growth Plan.

28. On March 26, 1998, Monica Bracone, a Florida resident with a reported net worth of $900,000, paid $8000 for the Growth Plan.

29. On April 2, 1998, Alan G. and Judy LeFort, Florida residents with a reported net worth of $200,000, paid $10,000 for the Growth Plan. In a second transaction, on June 8, 1998, the LeForts paid $5000 for the Growth Plan. In the second transaction, the yield is 35 percent, but the Participation Agreement notes a 36-month life expectancy of the viator. The different yields based on life expectancies are set forth below, but, as noted above, the standard yield was 42 percent, and, as noted below, this was based on a 36-month life expectancy, so Respondent miscalculated the investment return or misdocumented the investment on the LeForts' second transaction.

30. On April 29, 1998, Doron and Barbara Sterling, Florida residents with a reported net worth of $250,000, paid $15,000 for the Growth Plan. In a second transaction, on August 14, 1998, the Sterlings paid $100,000 for the Growth Plan. The yield for the second transaction is 35 percent, and the

Participation Agreement notes that the Sterlings were seeking a viator with a life expectancy of only 30 months.

31. When transmitting the closing documents for the second Sterling transaction, Respondent, writing ABS on Empire Insurance letterhead, stated in part:

> This guy has already invested with us (15,000) [sic]. He gave me this application but wants a 30 month term. Since he has invested, he did some research and has asked that he be put on a low T-cell count and the viator to be an IV drug user. I know it is another favor but this guy is a close friend and has the potential to put at least another 500,000 [sic]. If you can not [sic] do it, then I understand. You have done a lot for me and I always try to bring in good quality business. If this inventory is not available, the client has requested that we return the funds . . .

32. In a third transaction, on February 24, 1999, the Sterlings paid $71,973 for the Growth Plan. The yield is only 28 percent, but the Participation Agreement reflects the typical 36-month life expectancy for the viator. Although the investors would not have received this document, Respondent completed an ABS form entitled, "New Business Transmittal," and checked the box, "Life Expectancy 2 years or less (28%). The other boxes are: "Life Expectancy 2 1/2 years or less (35%)" and "Life Expectancy 3 years or less (42%)."

33. On May 4, 1998, Hector Alvero and Idelma Guillen, Florida residents with a reported net worth of $100,000, paid

$6000 for the Growth Plan. In a second transaction, on October 29, 1998, Ms. Guillen paid $5000 for the Growth Plan. In a third transaction, on November 30, 1998, Ms. Guillen paid $5000 for the Growth Plan. For this investment, Ms. Guillen requested an "IV drug user," according to Respondent in a letter dated December 1, 1998, on Empire Financial Consultants letterhead. This is the first use of the letterhead of Empire Financial Consultants, not Empire Insurance, and all letters after that date are on the letterhead of Empire Financial Consultants. In a fourth transaction, on January 29, 1999, Ms. Guillen paid $15,000 for the Growth Plan.

34. On April 23, 1998, Bonnie P. Jensen, a Florida resident with a reported net worth of $120,000, paid $65,884.14 for the Growth Plan. Her yield was 35 percent, but the Participation Agreement reflects a 36-month life expectancy.

35. On May 20, 1998, Michael J. Mosack, a Florida resident with a reported net worth of $500,000, paid $70,600 for the Income Plan. He was to receive monthly distributions of $580.10 for three years. The total yield, including monthly distributions, is $20,883.48, which is about 29.6 percent, and the Participation Agreement reflects a 36-month life expectancy.

36. On May 27, 1998, Lewis and Fernande G. Iachance, Florida residents with a reported net worth of $100,000, paid $30,000 for the Growth Plan.

37. On June 3, 1998, Sidney Yospe, a Florida resident with a reported net worth of $1,500,000, paid $30,000 for the Growth Plan. The yield is 35 percent, and the Participation Agreement reflects a 30-month life expectancy.

38. On June 12, 1998, Bernard Aptheker, with a reported net worth of $100,000, paid $10,000 for the Growth Plan. The yield is 35 percent, but the Participation Agreement reflects a 36-month life expectancy.

39. On June 10, 1998, Irene M. and Herman Kutschenreuter, Florida residents with a reported net worth of $200,000, paid $30,000 for the Growth Plan. The yield is 35 percent, but the Participation Agreement reflects a 36-month life expectancy.

40. On June 9, 1998, Daniel and Mary Spinosa, Florida residents with a reported net worth of $300,000, paid $10,000 for the Growth Plan. The yield is 35 percent, but the Participation Agreement reflects a 36-month life expectancy.

41. On June 5, 1998, Pauline J. and Anthony Torchia, Florida residents with a reported net worth of $300,000 and the parents of Respondent, paid $10,000 for the Growth Plan. The yield is 35 percent, but the Participation Agreement reflects a 36-month life expectancy.

42. On June 29, 1998, Christopher D. Bailey, a Florida resident with a reported net worth of $500,000, paid $25,000 for the Growth Plan. The yield is 35 percent, but the Participation

Agreement reflects a 36-month life expectancy. In a second transaction on the same day, Mr. Bailey paid $25,000 for the Growth Plan.

43. Petitioner submitted documents concerning a purported purchase by Lauren W. Kramer on July 21, 1998, but they were marked "VOID" and do not appear to be valid.

44. On July 22, 1998, Laura M. and Kenneth D. Braun, Florida residents with a reported net worth of $150,000, paid $25,000 for the Growth Plan, as Respondent completed the Participation Agreement. However, the agreement calls for them to receive $205.42 monthly for 36 months and receive a total yield, including monthly payments, of 29.6 percent, so it appears that the Brauns bought the Income Plan. In a second transaction, also on July 22, 1998, the Brauns paid $25,000 for the Growth Plan.

45. On January 20, 1999, Roy R. Worrall, a Florida resident, paid $100,000 for the Income Plan. The Participation Agreement provides that he will receive monthly payments of $821.66 and a total yield of 29.6 percent.

46. On July 16, 1998, Earl and Rosemary Gilmore, Florida residents with a reported net worth of $250,000, paid $5000 for the Growth Plan. In a second transaction, on February 12, 1999, the Gilmores paid $20,000 for the Growth Plan. The yield is 28 percent, but the Participation Agreement reflects a 36-month

life expectancy. The New Business Transmittal to ABS notes a life expectancy of two years or less.

47. On July 14, 1998, David M. Bobrow, a Florida resident with a reported net worth of $700,000 on one form and $70,000 on another form, paid $15,000 for the Growth Plan. The yield is 35 percent, but the Participation Agreement reflects a 36-month life expectancy. In a second transaction, on the same day, Mr. Bobrow paid $15,000 for the Growth Plan.

48. On July 27, 1998, Cecilia and Harold Lopatin, Florida residents with a reported net worth of $300,000, paid $10,000 for the Growth Plan.

49. On July 30, 1998, Ada R. Davis, a Florida resident, paid $30,000 for the Income Plan. Her total yield, including monthly payments of $246.50 for three years, is 29.6 percent. In a second transaction, on the same day, Ms. Davis paid $30,000 for the Income Plan on the same terms as the first purchase.

50. On July 27, 1998, Joseph F. and Adelaide A. O'Keefe, Florida residents with a net worth of $300,000, paid $12,000 for the Growth Plan.

51. On August 5, 1998, Thurley E. Margeson, a Florida resident, paid $50,000 for the Growth Plan.

52. On August 19, 1998, Stephanie Segaria, a Florida resident, paid $20,000 for the Growth Plan.

53. On August 26, 1998, Roy and Glenda Raines, Florida residents, paid $5000 for the Growth Plan. The yield is 35 percent, but the Participation Agreement reflects a 36-month life expectancy. The New Business Transmittal to ABS notes a life expectancy of 30 months or less. In a second transaction, on the same day, the Raineses paid $5000 for the Growth Plan. The yield is 35 percent, but the Participation Agreement reflects a 36-month life expectancy, although, again, the New Business Transmittal notes the life expectancy of 30 months or less.

54. On November 24, 1998, Dan W. Lipford, a Florida resident, paid $50,000 for the Growth Plan in two transactions. In a third transaction, on January 13, 1999, Mr. Lipford paid $30,000 for the Growth Plan.

55. On December 1, 1998, Mary E. Friebes, a Florida resident, paid $30,000 for the Growth Plan.

56. On December 4, 1998, Allan Hidalgo, a Florida resident, paid $25,000 for the Growth Plan.

57. On December 17, 1998, Paul E. and Rose E. Frechette, Florida residents, paid $25,000 for the Income Plan. The yield, including monthly payments of $205.41 for three years, is 29.6 percent.

58. On December 26, 1998, Theodore and Tillie F. Friedman, Florida residents, paid $25,000 for the Growth Plan.

59. On January 19, 1999, Robert S. and Karen M. Devos, Florida residents, paid $10,000 for the Growth Plan.

60. On January 20, 1999, Arthur Hecker, a Florida resident, paid $50,000 for the Income Plan. The yield, including a monthly payment of $410.83 for 36 months, is 29.6 percent.

61. On February 11, 1999, Michael Galotola, a Florida resident, paid $25,000 for the Growth Plan. In a second transaction, on the same day, Michael and Anna Galotola paid $12,500 for the Growth Plan.

62. On November 3, 1998, Lee Chamberlain, a Florida resident, paid $50,000 for the Growth Plan.

63. On December 23, 1998, Herbert L. Pasqual, a Florida resident, paid $200,000 for the Income Plan. The yield, including a monthly payment of $1643.33 for three years, is 29.6 percent.

64. On December 1, 1998, Charles R. and Maryann Schuyler, Florida residents, paid $10,000 for the Growth Plan.

65. Respondent and Empire Insurance were never aware of the fraud being perpetrated by FinFed and ABS at anytime during the 38 transactions mentioned above. Respondent attempted to verify with third parties the existence of the viaticated insurance policies.

66. When ABS presented its program to 30-40 potential agents, including Respondent, ABS presented these persons an opinion letter from ABS's attorney, stating that the investment was not a security, under Florida law. Respondent also contacted Petitioner's predecessor agency and asked if these transactions involving viaticated life insurance policies constituted the sale of securities. An agency employee informed Respondent that these transactions did not constitute the sale of securities.

CONCLUSIONS OF LAW

67. The Division of Administrative Hearings has jurisdiction over the subject matter. Sections 120.57(1) and 517.241(1), Florida Statutes. (All references to Sections are to Florida Statutes.)

68. These cases raise the questions whether the trust interests that Respondent and Empire Insurance sold are securities; if so, whether the trust interests are exempt securities; and, if they are nonexempt securities, whether the regulation of the trust interests falls exclusively under the Viatical Settlement Act, Chapter 626, Part X, Florida Statutes.

69. It is unlawful to sell unregistered securities in Florida. Section 517.07(1) provides:

> It is unlawful and a violation of this chapter for any person to sell or offer to sell a security within this state unless the

security is exempt under s. 517.051, is sold in a transaction exempt under s. 517.061, is a federal covered security, or is registered pursuant to this chapter.

70. It is unlawful for an unregistered person to sell securities in Florida. Section 517.12(1) provides:

> No dealer, associated person, or issuer of securities shall sell or offer for sale any securities in or from offices in this state, or sell securities to persons in this state from offices outside this state, by mail or otherwise, unless the person has been registered with the department pursuant to the provisions of this section. The department shall not register any person as an associated person of a dealer unless the dealer with which the applicant seeks registration is lawfully registered with the department pursuant to this chapter.

71. Section 517.021(6)(a), defines a "dealer" as a person who engages "as broker or principal in the business of offering, buying, selling, or otherwise dealing or trading in securities . . .." Rule 3E-200.001(7)(a) defines an "associated person" as "any person who for compensation refers, solicits, offers, or negotiates for the purchase or sale of securities . . .."

72. Section 517.301(1) generally prohibits fraud or deception in the sale of securities. However, this provision is irrelevant in these cases. There is no proof of fraud by Respondent or Empire Insurance.

73. Petitioner must prove the material allegations by clear and convincing evidence. Department of Banking and Finance v. Osborne Stern and Company, Inc., 670 So. 2d 932 (Fla. 1996) and Ferris v. Turlington, 510 So. 2d 292 (Fla. 1987). However, under Section 517.171, Respondent and Empire Insurance bear the burden of proving their entitlement to an exemption.

74. Section 517.021(i), (q), or (r) defines a "security" as a "certificate of interest or participation," "investment contract," or "beneficial interest in title to property, profits, or earnings." The trust interests in these cases appear to meet all three of these definitions of securities. Presumably, though, the case law discussed immediately below applies to all three definitions, even though it explicitly addresses only "investment contracts."

75. Under Securities and Exchange Commission v. W.J. Howey Co., 328 U.S. 293, 66 S. Ct. 1100, 90 L. Ed. 1244 (1946), an investment contract constitutes any contract, transaction, or scheme in which a person: 1) invests money; 2) in a common enterprise; 3) expects profit; and 4) solely from the efforts of other persons. Thirty years later, in United Housing Foundation, Inc., v. Forman, 421 U.S. 837, 95 S. Ct. 2051, 44 L. Ed.2d 2621 (1975), the Supreme Court eased the fourth requirement by restating it as expecting profits "from the

entrepreneurial or managerial efforts of others." 421 U.S. at 852, 95 S. Ct. at 2060.

76. In these cases, the investors obviously invested money, so the first Howey requirement is met.

77. The second Howey requirement is that the investors invest money in a common enterprise. Courts have identified "horizontal commonality," which is the stricter test and requires a pooling of all the investors' funds so that they are treated alike, and "vertical commonality," which is the easier-to-satisfy test and requires only that the investors' economic return be based on the essential managerial efforts of other persons.

78. In Farag v. National Databank Subscriptions, Inc., 448 So. 2d 1098 (Fla. 2d DCA 1984), the court rejected a defense based on the stricter horizontal commonality and seemed to adopt an approach consistent with vertical commonality, at least where the promoter obtains a "number of investors."

79. In Brown v. Rairigh, 363 So. 2d 590, 593 (Fla. 4th DCA 1978), cert. denied, 367 So. 2d 1122 (Fla. 1979), the court stated:

> [W]e adopt the view that not only should there be more than one investor, but that there should be some form of interaction between the investors, or, in the alternative, if there is no such interaction between the investors then the success of

the enterprise should be dependent upon obtaining a number of investors.

80. This approach to "common enterprise" in the courts is the same as the approach to "common enterprise" by Petitioner's predecessor agency in its final order in Department of Banking and Finance v. Philip E. Mehl, Sr., and Susan E. Mehl, DBF I 2002-397, DOAH Case No. 02-0526, p. 4 (Final Order issued October 17, 2002).

81. As in any Ponzi scheme, where the promoter fraudulently applies the money of later investors to pay obligations owed earlier investors, the investments in these cases were pooled, so as to satisfy the horizontal commonality test.

82. Additionally, the FinFed/ABS programs, as structured, pooled the investors' funds, although not at the trust level. In each transaction, the investor paid his money to an escrow agent, who, upon the satisfaction of the conditions in the Disbursement Letter of Instruction, paid the escrowed money to FinFed. At this point, the investor's funds were pooled with the funds of other investors. No investor paid a sufficient sum to purchase an entire insurance policy; in many cases, the investor's funds would pay for only a small fraction of a policy. Thus, the funds of multiple investors were necessarily pooled when the escrow agents paid them to FinFed, which, when

it received sufficient cash, was to assign portions of the purchased policy to individual trusts. See SEC v. Life Partners, Inc., 87 F.3d 536 (D.C. Cir. 1996).

83. The FinFed/ABS program also satisfies the vertical test of commonality. The success of the program was dependent upon finding a number of investors. First, as noted above, the program required multiple investors to acquire just one insurance policy. Second, the program required multiple investors for ABS to be able to honor the refund provisions. As noted above, if the viator had not yet died, investors could get their money back, without interest, at anytime up to 36 months, and, at 36 months, with a 15 percent total yield. The record discloses that ABS honored this obligation by selling the redeeming investor's trust interest to another investor.

84. The third Howey requirement is the expectation of profit. The strictest approach to this requirement is illustrated in SEC v. ETS Payphones, Inc., 300 F.3d 1281 (11th Cir. 2002). The investors bought individual payphones and leased them to an affiliate of the seller for a fixed monthly rental. The court held that these arrangements were not securities because of the absence of earnings or capital appreciation, concluding that the investors would not realize profits, only rent.

85. The FinFed/ABS program is different from the program in ETS Payphones. On their face, the Growth and Income plans appear to call for fixed returns on investment, such as 42 percent and 29.6 percent. Although the expressed rates of return are fixed, the terms are unfixed.

86. Assume a situation in which an investor has purchased the standard Growth Plan, which pays 42 percent at the expected maturity, which is marked by the death of the viator whose policy (or part thereof) forms the corpus of the trust. If the viator dies 12 months after the investor purchases the Growth Plan, the annual rate of return will be 42 percent, because the payout, not the expressed rate of return, is fixed. Likewise, if the viator dies 72 months after the investor purchases the Growth Plan, the annual rate of return will be five percent, if the investor cashed out at 36 months, or seven percent, if the investor patiently holds onto his investment. See Life Partners, cited above.

87. In any event, in the Mehl final order, cited above, Petitioner's predecessor agency rejected the ETS Payphones treatment of profits as to exclude investments bearing a fixed rate of return. Under this approach, the FinFed/ABS program clearly satisfies the third requirement of Howey because the investors expected to make money on their initial investments.

88. The fourth Howey requirement is that the investors' expectation of profits is based on the managerial or entrepreneurial efforts of others.

89. As noted above, Life Partners favors Petitioner on the Howey requirements of a common enterprise and expectation of profits. However, Life Partners favors Respondent and Empire Insurance on the fourth Howey requirement of managerial or entrepreneurial efforts of others. In Life Partners, the court held that the promoter of a viatical settlement investment program performed no significant post-investment acts.

90. The Life Partners decision emphasizes that the promoter has already medically underwritten each viator prior to the investor's purchase of a portion of the policy. However, the decision overlooks the entrepreneurial task of matching investors to viators. As noted above, the viability of this investment is the time that elapses until the viator's death--the sooner after the investment, the higher the return for the investor. The Life Partners court examines the pre-purchase medical underwriting, but ignores the crucial post-purchase process in which the promoter assigns viators to investors.

91. Perhaps Life Partners operated a simpler program, but the FinFed/ABS program offers Growth Plan investors three different projected maturation periods. Considerable expertise may be required to differentiate between one viator projected to

die in 24 months, another projected to die six months later, and another projected to die six months after that. Perhaps the record in Life Partners supported a finding that a promoter could perform all of the required matching pre-purchase (even though, by definition, no investor would have yet been identified). But the present record supports the finding that, in making the close calls distinguishing viators projected to die within six months of each other, ABS necessarily had significant work to do after the investor's purchase.

92. Another fact not reported in the Life Partners decision is the treatment accorded certain investors. As suggested in some of the correspondence, some investors sought preferred features in their viators, such as the twice-requested intravenous drug use. The correspondence from Respondent and Empire Insurance suggests that they believed that ABS was exercising important discretion in matching viators with investors, who did not know which policies (or parts thereof) their trusts were getting until after the closing. Respondent and Empire Insurance seemed to think that the bigger investors might get the shortest-lived viators, or at least the shortest-lived viators classified within the purchased class of 24-, 30-, and 36-month survivors.

93. One more fact distinguishes these cases from Life Partners. Even if the viator did not die, the investors in

these cases had a right to a return of their investment up to 36 months and a return of their investment, plus 15 percent, at 36 months. These crucial features of the FinFed/ABS program ostensibly provided a floor for the investments--investors could always get their principal and, after three years, could get their principal and a modest return. These safety features were entirely dependent, though, on the entrepreneurial expertise of ABS in reselling the trust interests of the redeeming investors.

94. Probably, Petitioner will join the many other states in rejecting this treatment of the fourth Howey requirement in Life Partners. See, e.g., Siporin v. Carrington, 200 Ariz. 97, 23 P.3d 92 (App. 2001); Michelson v. Voison, 658 N.W. 2d 188 (Mich.App. 2003); Poyser v. Flora, 780 N.E. 2d 1191 (Ind.App. 2003); and Joseph v. Viatical Management, LLC, 55 P.3d 264 (Colo.App. 2002). Clearly, under this authority, investors have relied on the managerial or entrepreneurial efforts of ABS in finding them suitable viators, before or after the closing.

95. Petitioner has thus proved that the trust interests in these cases are securities.

96. Respondent has not proved its entitlement to any of the exemptions contained in Chapter 517, Florida Statutes. Probably, the statutory exemption closest to the facts of this case is Section 517.051(10), which provides:

> Any insurance or endowment policy or annuity contract or optional annuity contract or self-insurance agreement issued by a corporation, insurance company, reciprocal insurer, or risk retention group subject to the supervision of the insurance commissioner or bank commissioner, or any agency or officer performing like functions, of any state or territory of the United States or the District of Columbia.

97. However, investors purchased trust interests--not insurance contracts--so Section 517.051(10) does not exempt these transactions from Chapter 517, Florida Statutes.

98. Notwithstanding the difficulty of some of the legal issues already discussed, the most difficult legal question in this case is whether the Office of Insurance Regulation has exclusive jurisdiction in these cases, pursuant to the Viatical Settlement Act, Chapter 626, Part X, Florida Statutes.

99. The Viatical Settlement Act is a comprehensive statutory scheme requiring pre-investment disclosure for the benefit of viators and purchasers of interests in viatical settlement agreements, registration of brokers and dealers, and broad anti-fraud prohibitions. As the following provisions suggest, the Office of Insurance Regulation has jurisdiction over the transactions described in these cases.

100. Sections 626.9911(9) and (10) provide:

> (9) "Viatical settlement purchase agreement" means a contract or agreement, entered into by a viatical settlement purchaser, to which the viator is not a

party, to purchase a life insurance policy or an interest in a life insurance policy, which is entered into for the purpose of deriving an economic benefit. The term also includes purchases made by viatical settlement purchasers from any person other than the provider who effectuated the viatical settlement contract.

(10) "Viatical settlement purchaser" means a person who gives a sum of money as consideration for a life insurance policy or an equitable or legal interest in the death benefits of a life insurance policy that has been or will be the subject of a viatical settlement contract, for the purpose of deriving an economic benefit, including purchases made from any person other than the provider who effectuated the viatical settlement contract or an entity affiliated with the provider. The term does not include a licensee under this part, an accredited investor as defined in Rule 501, Regulation D of the Securities Act Rules, or a qualified institutional buyer as defined by Rule 144(a) of the Federal Securities Act, a special purpose entity, a financing entity, or a contingency insurer. The above references to Rule 501, Regulation D and Rule 144(a) of the Federal Securities Act are used strictly for defining purposes and shall not be interpreted in any other manner. Any person who claims to be an accredited investor shall sign an affidavit stating that he or she is an accredited investor, the basis of that claim, and that he or she understands that as an accredited investor he or she will not be entitled to certain protections of the Viatical Settlement Act. This affidavit must be kept with other documents required to be maintained by this act.

101. Investors in these cases are viatical settlement purchasers. Sections 626.99235 and 626.99236 provide a comprehensive set of disclosures that they must receive.

102. However, a distinct question is whether the Office of Insurance Regulation has exclusive jurisdiction over the transactions in these cases, or whether its jurisdiction overlaps with the jurisdiction of the Office of Financial Institutions and Securities Regulation. No provision in Chapter 517, Florida Statutes, or the Viatical Settlement Act expressly answers this question.

103. Section 626.99245(1) explicitly mentions the absence of regulation in Florida, but only under certain conditions. Section 626.99245(1) provides:

> A viatical settlement provider who from this state enters into a viatical settlement purchase agreement with a purchaser who is a resident of another state that has enacted statutes or adopted regulations governing viatical settlement purchase agreements, shall be governed in the effectuation of that viatical settlement purchase agreement by the statutes and regulations of the purchaser's state of residence. If the state in which the purchaser is a resident has not enacted statutes or regulations governing viatical settlement purchase agreements, the provider shall give the purchaser notice that neither Florida nor his or her state regulates the transaction upon which he or she is entering. For transactions in these states, however, the viatical settlement provider is to maintain all records required as if the transactions were executed in Florida. However, the

forms used in those states need not be approved by the department.

104. However, the statement in Section 626.99245(1) that Florida does not regulate the viatical purchase agreement means merely that Florida does not regulate such agreements when the purchasers reside outside of Florida. The registration requirements of Sections 517.07(1) and 517.12(1) are both predicated on sales within Florida; thus, a viatical purchase agreement sold to a nonFlorida purchaser might be a security, but would not be within the reach of Florida's securities laws.

105. Overlapping jurisdiction is not unprecedented. See, e.g., Elder v. Fischer, 717 N.E. 2d 730 (OhioApp. 1st Dist. 1998).

106. In Lemelledo v. Beneficial Management Corp. of America, 150 N.J. 255, 696 A.3d 546 (1997), the court considered a case involving "loan packing," in which a lender allegedly increased the amount of a consumer loan with undesired services, such as various forms of credit insurance. The plaintiff alleged violations of the Consumer Fraud Act (CFA) and the Consumer Loan Act. The court noted that lenders offering credit insurance stated were subject to regulation by several state agencies, including the Department of Insurance and the Department of Banking.

107. The Lemelledo court then considered the problems of underenforcement:

> Both of those aspects of the CFA--its recognition of cumulative remedies and its empowerment of citizens as private attorneys general--reflect an apparent legislative intent to enlarge fraud-fighting authority and to delegate that authority among various governmental and nongovernmental entities, each exercising different forms of remedial power. That legislative intent is readily inferable from the ongoing need for consumer protection and the salutary benefits to be achieved by expanding enforcement authority and enhancing remedial redress. When remedial power is concentrated in one agency, underenforcement may result because of lack of resources, concentration on other agency responsibilities, lack of expertise, agency capture by regulated parties, or a particular ideological bent by agency decisionmakers. See, e.g., Arcadia v. Ohio Power Co., 498 U.S. 73, 87-88, 111 S.Ct. 415, 423-24, 112 L.Ed. 2d 374,388-89 (1990). (Stevens, J., concurring) (emphasizing that Congress intended that Securities and Exchange Commission and Federal Energy Regulatory Commission both have jurisdiction over particular aspect of utility regulation because of the "difference between the goals and expertise of the two agencies"). Underenforcement by an administrative agency may be even more likely where, as in this case, the regulated party is a relatively powerful business entity while the class protected by the regulation tends to consist of low-income persons with scant resources, lack of knowledge about their rights, inexperience in the regulated area, and insufficient understanding of the prohibited practice. The primary risk of underenforcement--the victimization of a protected class--can be greatly reduced by allocating enforcement responsibilities among various agencies and among members of

> the consuming public in the forms of judicial and administrative proceedings and private causes of action.
>
> The Legislature, of course, need not diffuse enforcement power to combat fraud, and it certainly may concentrate that authority in one or more agencies or in private citizens. That judgment, however, is for the Legislature, not for this Court. We are loathe to undermine the CFA's enforcement structure, which specifically contemplates cumulative remedies and private attorneys general, by carving out exemptions for each allegedly fraudulent practice that may concomitantly be regulated by another source of law. The presumption that the CFA applies to covered practices, even in the face of other existing sources of regulation, preserves the Legislature's determination to effect a broad delegation of enforcement authority to combat consumer fraud.

150 N.J. at 269-70, 696 A.3d at 553-54.

108. As was the case in Lemelledo, Section 517.241 provides for private rights of action and cumulative remedies for violations of Chapter 517.

109. The Lemelledo court also noted that the two statutory schemes did not create a conflict, which, to create the inference not to apply both statutes, must be "patent and sharp," and not the "mere possibility of incompatibility." 150 N.J. at 270, 696 A.3d at 554.

110. The Lemelledo court observed:

> In the modern administrative state, regulation is frequently complementary, overlapping, and comprehensive. Absent a

> nearly irreconcilable conflict, to allow one remedial statute to preempt another or to co-opt a broad field of regulatory concern, simply because the two statutes regulate the same activity, would defeat the purposes giving rise to the need for regulation. It is not readily to be inferred that the Legislature, by enacting multiple remedial statutes designed to augment protection, actually intended that parties be subject only to one source of regulation. Cf. Hinfey v. Matawan Regional Bd. of Educ., 77 N.J. 514, 527-28, 391 A.2d 899 (1978) (holding that more specific antidiscrimination statute did not preempt broader antidiscrimination statute despite the existence of separate administrative bodies charged with combatting the same form of discrimination); Dodd, supra, 365 N.E. 2d at 805 ("The mere existence of one regulatory statute does not affect the applicability of a broader, nonconflicting statute, particularly when both statutes provide for concurrent coverage of their common subject matter.").

111. Examining the statutes in question, the Lemelledo court noted that the objective of both statutes was the prevention of fraud in the sale of credit or insurance. The court reasoned that subsequent courts enforcing both statutes could avoid conflicting results by not imposing conflicting duties or imposing duplicative financial obligations on the regulated parties. Likewise, the Lemelledo court suggested that the agencies could harmonize their exercise of jurisdiction to avoid the possibility of conflict. The agency with primary jurisdiction could act first, and the deferring agency could wait to take action to award complementary or additional relief.

112. In these cases, one agency, the Department of Financial Services, has jurisdiction over the Viatical Settlement Act and Chapter 517, Florida Statutes. The Department's Office of Insurance Regulation has jurisdiction over the viatical settlements, and the Department's Office of Financial Institutions and Securities Regulation has jurisdiction over securities. Thus, the potential for inter-agency conflict is nonexistent.

113. Even ignoring the fact that one agency has jurisdiction over viatical settlements and securities, the issue of relative expertise suggests primary jurisdiction in this case rests with the Office of Financial Institutions and Securities Regulation.

114. Insurance law regulates the initial viatical transaction, in which the viator conveys ownership of his life insurance policy. This phase of the overall transaction will typically involve recurring insurance issues, such as fraud against the insurer in the form of clean sheeting (in which insurance applicants may hide disqualifying conditions from the insurer) and fraud against the insured, or viator.

115. However, securities law better regulates the ensuing phases of the overall transaction, when brokers or dealers assemble fractional interests of several policies, perhaps with other investments, and market investment contracts, such as

trust interests. By these phases, securities law better serves the needs of the marketplace that are jeopardized by such frauds as Ponzi schemes or inadequately trained brokers and dealers, whose viatical training and licensing is less pertinent than securities training and licensing.

116. Section 517.221(1) provides that Petitioner may impose a cease and desist order against any person who has violated any provision of Chapter 517, Florida Statutes. Section 517.221(3) provides that Petitioner may impose an administrative fine of $5000 per violation.

117. Petitioner seeks fines of $380,000 against each Respondent. Petitioner alleged that Respondent and Empire Insurance sold to 38 different purchasers, and the failure to register the security and failure to register as a dealer constitute two separate violations by each Respondent with respect to each of the 38 purchasers. This approach overlooks the fact that Empire Financial Consultants replaced Empire Insurance by December 1, 1999.

118. More importantly, the proposed fines are excessive. These cases appear to have been only the third time, all in recent months, that Petitioner has attempted to impose securities laws upon the type of transactions in which FinFed, ABS, Respondent, and Empire Insurance engaged. The applicability of the securities laws to these transactions has

been a very close question, on which there exists presently no consensus.

119. The <u>Life Partners</u> decision in particular may have understandably misled many informed persons into concluding that the securities laws do not apply to the facts involved in these cases. Petitioner's predecessor agency expressed this opinion to Respondent when he approached it for guidance. But the closer question arises from the Legislature's recent adoption of the Viatical Settlement Act. Specific to viaticals, this legislation, on its face, understandably may seem to deal definitively with all aspects of the transactions involved in these cases.

120. The novelty of the legal issues involved in these cases militates against a harsh penalty. On the other hand, many innocent investors lost a considerable sum of money due to the FinFed/ABS investments that Respondent and Empire Insurance promoted. And Respondent's claims of due diligence in verifying the existence of the viaticated insurance policies are undermined by his reckless promotion of the FinFed/ABS investments as guaranteed and safe; sloppy completion of the closing documents, which often fail to reflect the proper projected life expectancies; carelessness in noting reported net worths for many clients; and sale of FinFed/ABS investments that, based on reported net worths, were clearly unsuitable,

such as, most notably, in the case of the Sterlings, who invested about $187,000 of their $250,000 net worth, and Bonnie Jensen, who invested about $66,000 of her $120,000 net worth. Of course, Respondent's claims of due diligence in verifying the existence of the viaticated insurance policies are also undermined by the fact that, for the most part, there were no policies. Overall, Respondent, an insurance agent, repeatedly demonstrated incompetence in discharging his securities-like responsibilities--once more underscoring the primacy of securities regulation over insurance regulation of these later phases of the FinFed/ABS transactions.

121. In 50 separate transactions, Respondent has violated Section 517.07(1), and, in 50 separate transactions, he has violated Section 517.12(1). Petitioner has charged him with only 38 such violations of each statute, for a total of 76 violations. Empire Insurance has similarly violated these statutes, except that it ceased its activities by December 1, 1998, so that it is not liable for any transactions from that date forward.

122. After considering all of the mitigating and aggravating circumstances, the total fine should equal Respondent's approximate commissions, or $120,000. Because it is doubtful that Empire Insurance has remained in business or has any assets, the entire fine should be imposed against

Respondent. Petitioner should also order each Respondent to cease and desist from further violations of Chapter 517, Florida Statutes.

RECOMMENDATION

It is

RECOMMENDED that Petitioner enter a final order:

1. Finding James A. Torchia and Empire Insurance, Inc., not guilty of violating Section 517.301(1), Florida Statutes;

2. Finding James A. Torchia guilty of 38 violations of Section 517.07(1), Florida Statutes, and 38 violations of Section 517.12(1), Florida Statutes;

3. Finding Empire Insurance, Inc., guilty of 38 violations of Section 517.07(1), Florida Statutes, and 38 violations of Section 517.12(1), Florida Statutes, except for transactions closed on or after December 1, 1998;

4. Directing James A. Torchia and Empire Insurance, Inc., to cease and desist from further violations of Chapter 517, Florida Statutes; and

5. Imposing an administrative fine in the amount of $120,000 against James A. Torchia.

DONE AND ENTERED this 19th day of May, 2003, in Tallahassee, Leon County, Florida.

ROBERT E. MEALE
Administrative Law Judge
Division of Administrative Hearings
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Filed with the Clerk of the
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this 19th day of May, 2003.

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NOTICE OF RIGHT TO SUBMIT EXCEPTIONS

All parties have the right to submit written exceptions within 15 days from the date of this recommended order. Any exceptions to this recommended order must be filed with the agency that will issue the final order in this case.