IN THE MATTER OF THE SECURITIES ACT
R.S.O. 1990, CHAPTER S.5, AS AMENDED (the Act)

AND

IN THE MATTER OF UNIVERSAL SETTLEMENTS INTERNATIONAL INC.

Hearing:	June 26, 28, 30, July 6, and 27, 2006		
Decision and Reasons:	September 29, 2006		
Panel:	Paul M. Moore, Q.C.	-	Vice-Chair and Chair of the Panel
	Harold P. Hands	-	Commissioner
	Wendell S. Wigle, Q.C.	-	Commissioner
Counsel:	Randy Bennett Sara J. Erskine Stephany Mandin	-	for Universal Settlements International Inc.
	Yvonne B. Chisholm	-	for Staff of the Ontario Securities Commission

DECISION AND REASONS

DECISION

[1] For the reasons set out below, we have decided that the viatical products offered by Universal Settlements International Inc. (USI) are investment contracts under s. 1(1) of the Act and, therefore, are securities. As a result, USI will need to comply with the registration and prospectus requirements of the Act in order to continue to offer such products.

[2] Counsel agreed that a separate sanctions hearing would be unnecessary if we found that USI's viatical products are securities.

[3] USI, acting on considered legal advice, believed that its products were not securities. It provided risk disclosure to investors, and required its sales agents to address suitability considerations for investors.

[4] Staff made no allegation of improper conduct, or fraud, on the part of USI or its agents, and there was no evidence that investors did not understand what they were acquiring. Indeed, the investors and sales agents we heard from confirmed that investors knew they were acquiring interests in death benefits (sometimes called viaticals) of life insurance policies from insured persons (viators), and that, apart from the depreciation of the value of the U.S. dollar as against the Canadian dollar and delays in purchasing viaticals, they had no significant complaints concerning their investments.

[5] Staff did not seek sanctions against USI under s. 127 of the Act, apart from a cease trade order, and we do not believe it would be in the public interest to make any of the other orders we are authorized to make under the section.

[6] Our decision should not have a negative impact on existing investments of investors of USI. However, we recognize that it may take a while for USI or its agents to become registered under the Act. Accordingly, in the order we are making concurrently, we are exempting USI and its agents from the cease trade order and, prospectively only, the registration and prospectus requirements of the Act, but only in so far as may be necessary for them to complete tasks relating to existing investments of investors. The exemption does not apply to acts in furtherance of trades relating to moneys from investors held by USI or its agents for investment in viaticals that have not already been committed to specific viators. Such moneys should be returned to the investors, forthwith. The exemption will not derogate from any rights an investor may have against USI for failure to deliver a prospectus for investments in viaticals already made.

REASONS

ALLEGATIONS

[7] Staff commenced proceedings against USI on January 16, 2006 pursuant to s. 127 and s. 127.1 of the Act. In its amended statement of allegations, staff alleged the following:

(a) USI is not registered under the Act and is not exempt from registration,

(b) USI traded in securities contrary to s. 25 of the Act, and

(c) USI distributed securities without a prospectus contrary to s. 53 of the Act and is not exempt from prospectus requirements.

THE ISSUE

[8] The key issue in this hearing was whether the viatical products USI offers to investors in Ontario are investment contracts under the definition of securities in s. 1(1) of the Act. If they are investment contracts, the prospectus and registration requirements of the Act apply.

[9] Based on the three pronged test for an investment contract set out in the leading American case of *Securities and Exchange Commission v. W .J. Howey Co. et al*, 328 U.S. 293 (1946) as slightly modified by later cases, the viatical products of USI would constitute investment contracts under s. 1(1) of the Act, if they involve: (i) an investment of funds with a view to profit, (ii) in a common enterprise, (iii) where the profits are derived from the undeniably significant efforts of persons other than the investors.

[10] Staff and the respondent agreed that the viatical products offered by USI involve an investment of funds with a view to profit. Therefore, the issue was whether there is a common enterprise, where the profits are derived from the undeniably significant efforts of persons other than the investors.

UNIVERSAL SETTLEMENTS INC.

[11] USI is a private Ontario corporation that has carried on business in Canada and elsewhere since 1997. Its business involves finding investors interested in investing in viaticals and American viators interested in selling viaticals. USI has approximately 1,200 independent agents who seek out investors using marketing material supplied by USI. It had over 800 clients between 1999 and 2005 who invested approximately US $29 million in viaticals. The smallest investment was US $5,000. The largest was over US $7 million. Most of the investments were in the lower range.

[12] USI is not registered under the Act and has not filed any prospectus under the Act for its viatical products.

THE VIATICAL PRODUCTS

[13] USI sells two viatical products, GLS-II and GLS.

[14] Under GLS-II, an investor acquires from a specific viator, usually a terminally ill or very

old person, a fractional interest in the death benefit of a specific life insurance policy. GLS is identical to GLS-II, except GLS also provides investors with the protection of third party contingency insurance that pays an amount equal to the death benefit if the viator has not died by an agreed upon date (usually two years beyond the estimated date of death of the viator). If a payout occurs on the contingency insurance, the death benefit under the life insurance becomes payable to the contingency insurer.

STAFF'S SUBMISSIONS

[15] With respect to "commonality", staff argued that the enterprise is common among investors and among investors and USI because: the investors rely on USI's efforts to make their investment profitable; the investor with a fractional interest in a death benefit needs the participation of the other investors with fractional interests in the death benefit and they share proportionately in the death benefit; and USI would receive nothing without the investors' involvement.

[16] With respect to "enterprise", staff submitted that there is an enterprise when one considers the commonality factor and the efforts of USI, including: (i) preparing and disseminating marketing materials; (ii) preparing standard form purchase agreements; (iii) recruiting agents to sell GLS-II and GLS to investors on USI's behalf; (iv) communicating with investors and agents; (v) directing the flow of funds from the investors to the viators; (vi) establishing trusts and escrow arrangements; (vii) estimating the amounts necessary to set aside to pay premiums until the viator dies; (viii) providing for the transfer of ownership of life insurance policies and the use of investor funds to pay premiums to maintain policies; (ix) finding viators and life insurance policies appropriate to an investor's criteria; (x) bidding on life insurance policies and negotiating the discounted price a viator receives; (xi) retaining independent medical experts to determine a viator's life expectancy; (xii) monitoring and tracking the viator's life; (xiii) arranging contingency insurance for GLS; and (xiv) paying out death benefits or contingency insurance payments.

[17] This common enterprise is not coterminous with the business enterprise of USI.

[18] With respect to "profits" and "efforts of others", staff argued that the profits from the common enterprise are not dependent in a significant or essential manner on the viator's death or the contingency insurance payouts – those are given and will inevitably happen – but rather on the efforts of USI and its agents.

RESPONDENT'S SUBMISSIONS

[19] With respect to "commonality", the respondent submitted that there is nothing common between investors – each could acquire a whole death benefit, and some did. With respect to fractional interests, we would have to find each whole viatical divided into fractional interests to be a separate common enterprise, if we determined it was fractional interests that constituted the common element tying investors into a common enterprise.

[20] With respect to "enterprise", the respondent argued that the only enterprise is the business of USI and that investors' funds are not invested in that. They are segregated and held in trust for investors and are not used by USI in its business. Nor are they subject to the insolvency risk of USI as they are not part of the assets of USI. Indeed, the obligations to investors are property rights and obligations that flow from the death benefits or contingency insurance that belong to the investors (or persons holding them in trust for the benefit of the investors) and are owed by the insurance companies, not by USI.

[21] With respect to "profits", the respondent argued that the profits from GLS-II and GLS are not derived from undeniably significant efforts of USI, but rather are derived from the death of the viator or the maturity of the contingency insurance.

DISCUSSION OF THE FACTS

[22] Although the parties did not present an agreed statement of the facts, no facts were in dispute, except the fact of when the proposed period of engagement referred to below is measured from.

[23] We heard from a staff investigator, two investors, two sales agents, the president of the U.S. accounting firm that provides trust and escrow services to USI in the United States, and the president of USI.

[24] There were also three other investors staff had intended to call as witnesses, but we suggested, and the parties agreed, that their testimony would be unnecessary.

[25] Staff and the respondents presented us with many volumes of documents including promotional material, purchase contracts, and closing packages for five investors.

Investments in GLS-II and GLS

[26] An investor in GLS-II or GLS makes his investment in U.S. dollars and all payments on the investment are similarly denominated.

[27] The investor makes his investment in GLS-II or GLS when he signs a purchase agreement with USI and pays the committed amount to a Canadian trust established by USI.

[28] The investor is given a disclosure document warning of the illiquidity of the investment and other risks.

[29] The purchase of a viatical in which the investor obtains a beneficial interest occurs some time after he has paid the committed amount.

[30] The investor is given a ten-day right of rescission from the date he signs the purchase agreement and pays the committed amount. After the expiry of the right of rescission the investor

may, on request, receive a full refund of the committed amount less a 15 percent fee. However, if USI is unable to purchase a suitable death benefit from a suitable viator, USI may be willing to return the investor's committed amount without deduction. USI may also be willing to return the committed amount without deduction where the sales agent has not explained to the investor the possibility of delay before an appropriate death benefit can be purchased.

[31] One fact that was unclear to us was whether the proposed period of engagement was supposed to be matched by USI to the period that begins with the time of payment of the committed amount by the investor or from the time of acquisition of a death benefit or from some other time. It appears from purchase agreements that USI is supposed to match the beginning of the proposed period of engagement to the date that ownership of the viatical is transferred from the viator. However, in at least one case it appears that it may actually have been related to the date of the life expectancy estimate set out in the report of the medical expert.

[32] Sales agents, normally also involved in the sale of life insurance, and generally quite knowledgeable in this area, are selected by USI to distribute its products.

[33] Although USI is willing to acquire a viatical for one investor, it offers fractional interests. In fact, because most investors want to commit amounts less than the full cost of a viatical, most of USI's investors have acquired fractional interests in viaticals.

[34] USI finds each investor, ascertains the amount of money he wants to invest (the committed amount), and the length of time the investor is prepared to be tied to the investment (the proposed period of engagement), and describes to the investor the absolute return that will result when a payment occurs under the applicable policy of insurance.

[35] The absolute return offered to investors is the difference between the investor's committed amount and the payout under the viatical. USI offers committed amounts and payouts taking into account considerations such as the likelihood of locating acceptable viators and viaticals, the investor's proposed period of engagement, whether there is to be contingency insurance (where the absolute return will be reduced to reflect the cost of such insurance), fees, expenses, the spread USI takes for its services, and the discounted purchase price USI believes it will be able to negotiate for an acceptable viatical.

[36] A viator is selected by USI so that the estimated date of death of the selected viator will be approximately two years before the end of the proposed period of engagement selected by the investor. If GLS is selected, the maturity date of the contingency insurance is the end of the proposed period of engagement.

Rates of return

[37] Although USI asserts that returns are described by USI in absolute return terms (i.e., amounts payable as death benefits or contingency insurance as a percentage of the committed amount), USI's marketing material compares returns on its viatical products with the returns under products, such as GICs and mortgages, over a period of time equivalent to the proposed period of engagement.

[38] Under GLS-II, if a viator dies before the end of the proposed period of engagement, the investor's annualized rate of return will be higher than a conservatively estimated (based on life expectancy plus two years) annualized rate of return. If the viator dies after the end of the proposed period of engagement, the investor's annualized rate of return will be less than a conservatively estimated annualized rate of return.

[39] Under GLS, the investor will face the same consequences for the annualized rate of return as under GLS-II if the viator dies before the end of the proposed period of engagement. If the viator dies after the period, the contingency insurance will have matured and the annualized rate of return will be equivalent to a conservatively estimated annualized rate of return based on life expectancy plus two years.

[40] No interest or other return is paid to the investor on the committed amount for the period of time after the funds are paid and before the funds are used to acquire an interest in a death benefit.

[41] The time between the date the investor pays his committed amount and the date he acquires an interest in a death benefit can have an effect on his annualized rate of return, where the proposed period of engagement is matched to run from a date that is later than the date of payment of the committed amount. However, the time delay has no effect on the investor's entitlement to the absolute return specified in the purchase agreement.

[42] There is sometimes a delay between the time when a death benefit becomes payable or contingency insurance matures and the time when the insurance company settles and pays out the claim. This, too, impacts the actual annualized rate of return that the investor receives on his investment, but not the absolute return.

Flow of funds

[43] USI has established a Canadian trust and a U.S. trust to manage the flow of funds from and to investors.

[44] When an investor pays the committed amount, it is placed in the Canadian trust.

[45] The committed amount is not taken by USI into its own funds. No interest is earned on the funds while they are held in the Canadian trust.

[46] When USI has agreed with a viator to acquire an interest in a death benefit, USI instructs the Canadian trust to pay the committed amount to the U.S. trust.

[47] Funds held by the U.S. trust earn interest that is paid to the trustee for its services, and for taxes and expenses.

[48] USI instructs the U.S. trust to hold a specified amount of the committed amount in a premium reserve account, and to pay from the committed amount various expenses, such as contingency insurance premiums and service fees of others such as the medical expert doing the

life expectancy estimates, and to pay from the committed amount the purchase price for the interest in the death benefit to the viator or his agent, and to remit the balance to USI for its own account.

[49] When a viatical is acquired, the life insurance policy is changed to show the U.S. trust as the legal owner of the policy. USI issues to investors certificates of beneficial ownership. When the insurance company pays the death benefit, it does so to the U.S. trust. USI directs the U.S. trust to pay funds to investors.

[50] If there is contingency insurance that matures, the contingency insurance company pays the claim to the Canadian trust, and the trust, on the instructions of USI, pays the investors.

Premiums on life insurance

[51] USI calculates the funds that will be sufficient to pay premiums on the life insurance for each viatical acquired for a period ending two years after the estimated date of death of the viator and the U.S. trust uses the premium reserve account to pay premiums.

[52] If a viator dies before funds in the premium reserve account have been exhausted, the remaining funds in the account are added to a general premium account.

[53] If the premium reserve account for a life insurance policy is exhausted because the viator lives beyond two years from the estimated date of death, the trustee uses the general premium account to pay premiums. This is not the case when there is contingency insurance. Once the contingency insurance becomes payable, the contingent insurer becomes the beneficiary of the life insurance and USI and the investors no longer have any interest in paying premiums to maintain the insurance in good standing.

[54] USI is the residual beneficiary of the U.S. trust and is entitled to any remaining assets in the general premium account when the trust is terminated.

[55] We had no evidence before us to suggest that investors or USI had any obligation to pay premiums on insurance if the premium reserve account and the general premium account became exhausted. But we were advised that this situation has never occurred and was unlikely to ever occur.

Efforts of USI

[56] When USI has sufficient funds from investors, USI seeks out potential viators, who usually are terminally ill persons or elderly persons who wish to capitalize on their life insurance policies by selling the amount payable by the insurance company on the viator’s death (death benefit) for a price which is invariably less than the full face amount.

[57] Only unencumbered life insurance policies in good standing from creditworthy insurance

companies are considered.

[58] USI engages independent service providers to prepare proper life expectancy estimates and to track and monitor the viators' health and date of death.

[59] USI ensures that life policies under consideration are past their contestability and suicide period.

[60] USI selects the insurer to underwrite the contingency insurance for GLS.

[61] USI matches viators and viaticals with the parameters set for investment by each investor. This entails matching life expectations for viators, plus two years, with the proposed period of engagement of investors, and aggregating funds of a sufficient number of investors to purchase whole viaticals from viators. USI almost never purchases fractional interests in viaticals.

[62] This matching generally begins after investors commit funds to USI and can take as long as nine months or more after the commitment date. In some cases, no match can be found and USI returns the funds committed by the investor.

[63] Before agreeing with a viator or his agent on the actual purchase price for a viatical, USI determines what it will offer by deducting from committed amounts paid by investors a 5% spread for itself, an amount sufficient to pay premiums on the policy for the proposed period of engagement, and an amount sufficient to pay medical experts and other agents, and if contingency insurance is involved, the cost of such insurance.

[64] The purchase of viaticals is very competitive. USI considers it is doing well if it wins one in ten bidding contests for viaticals. In some cases, USI may accept less than its 5% spread in order to win the bid for a viatical.

[65] When the purchase of a viatical is made, the investor is assigned a fractional interest in the viatical. He does not acquire an interest in a pool of more than one viatical, although over time, may, through multiple investments, have fractional interests in more than one viatical.

[66] USI sends an investor a closing package once USI purchases the viatical. The closing package includes a copy of assignment of the interest in the death benefit to the U.S. trust, a medical review estimating life expectancy, a beneficiary designation, financial ratings of the viator's insurance company, and the contingency policy of insurance where applicable. The beneficiary designation lists the U.S. trust as the beneficiary for the life policy.

[67] USI monitors when the contingency policy matures and is responsible for making claims under the policy.

[68] Investors do not select viators, do not approve life expectancy estimates, do not participate in the negotiation of or have knowledge of the purchase price of the viatical, and are unaware of the fees, expenses and spread USI incurs or retains on a transaction and are unaware of the premiums that need to be paid to keep the insurance in good standing.

[69] Investors have no part in the selection or retention of medical experts to conduct life

expectancy estimates and generally do not know the identity of the viator and have no part in monitoring the life of the viator.

[70] In various materials prepared for its agents or its investors, USI has stated:

> – Universal Settlements International Inc. ensures that extensive and prudent medical underwriting has been performed on all our Life Settlements.
>
> – The most significant benefit [USI provides] to clients and representatives by the implementation of these changes [to USI's programs] is that the placement of your clients' funds will be accomplished in a much shorter time span.
>
> – Universal Settlements has long been recognized as a leader in developing and offering creative life settlement solutions. We were one of the first with a reinsured product.
>
> – USI has created the most secure life settlement product available. Our Guaranteed Life Settlement (GLS) has eliminated all risk for the purchaser.
>
> – We retained American Viatical Services (AVS) to perform our medical underwriting. After much due diligence, we selected AVS to look after this cornerstone of our business. AVS is staffed with several reviewing physicians and scientists and are recognized as the best in the business.
>
> – We invite you to compare GLS to other popular investment vehicles. GLS offers you a unique blend of security and potential high yield.

[71] Failure by USI and its agents to diligently carry out their responsibilities would jeopardize the ability of investors to realize their profit from the investment.

DISCUSSION OF THE LAW

[72] Subsection 1(1) of the Act defines "security" to include "any investment contract". The term "any investment contract" is not defined in the Act.

[73] We considered the following cases submitted to us: *Pacific Coast Coin Exchange of Canada v. Ontario Securities Commission* (1977), 80 D.L.R. (3d) 529 (S.C.C.); *Securities and Exchange Commission v. W.J. Howey Co.*, 328 U.S. 293 (1946); *State of Hawaii, Commissioner of Securities v. Hawaii Market Centre, Inc.*, 485 P.2d 105 (Hawaii Sup. Ct. 1971); *SEC v. Life Partners Inc.*, 87 F.3d 536 (D.C. Cir. 1996); *SEC v. Life Partners Inc.*, 102 F.3d 587 (D.C. Cir. 1996); *SEC v. Life Partners Inc.*, 986 F. Supp. 644 (D.C. Cir. 1997); *SEC v. Mutual Benefits Corp.*, 408 F.3d 737 (11th Cir. 2005); *Siporin v. Carrington*, 23 P.3d 92 (Ariz. C.A. 2001); *British Columbia v. Lazerman Investment Metals International Inc.*, [1985] B.C.J. No. 2338 (C.A.); *R. v. Sisto Finance*, [1994] O.J. No. 1184 (Ct. J. (Prov. Div.)); *Flora v. Poyser*, 780 N.E.2d 1191 at 1197 (Ind. C.A. 2003); *Griffitts v. Life Partners Inc.*, 2004 Tex. App. LEXIS

4844 (Tex. C.A. 2004); *Joseph v. Viatica Management LLC*, 55 P.3d 264 (Colo. C.A. 2002); *Wuliger v. Eberle*, 414 F. Supp. 2d 814 (N.D. Ohio 2006); *Rumbaugh v. Ohio DOC*, 800 N.E.2d 780 (Ohio C.A. 2003); *Ainsley Financial Corporation v Ontario Securities Commission* (1993), 14 O.R. (3d) 280 (Ct. J. (Gen. Div.)); *Committee for the Equal Treatment of Asbestos Minority Shareholders v. The Queen in right of Quebec et al.* (2001), 199 D.L.R. (4th) 577 (S.C.C.); *Pezim v. British Columbia (Superintendent of Brokers)* (1994), 114 D.L.R. (4th) 385 (S.C.C.); *Gregory & Co. v. Quebec (Securities Commission)*, [1961] S.C.R. 584; *Charbonneau (Re)* (1997), 6 ASCS 3076 (Alta. Sec. Com.); *Corporate Express Inc. (Re)*, 2005 LNBCSC 10 (B.C. Sec. Com.); *Re Ontario Securities Commission and C&M Financial Consultants* (1979), 23 O.R. (2d) 378 (H.C.); *Lett (Re)* (2004), 27 OSCB 3215 (Ont. Sec. Com.); *Lett (Re)* (8 June 2004), Toronto (Ont. Sec. Com.) [Sanctions Reasons]; *Ontario (Securities Commission) v. Lett*, [2006] O.J. No. 751 (Sup. Ct.); *Her Majesty the Queen v. Consortium Financial Inc. and Pia Williamson* (1992), 15 OSCB 4091 (Ont. Sec. Com.); *Yuen Chow International Group (Re)*, 1995 LNBCSC 30 (B.C. Sec. Com.); *Pac Industries, Inc. (Re)*, 1987 LNBCSC 1162 (B.C. Sec. Com.); *Sunfour Estates N.V. (Re)* (1992), 15 OSCB 269 (Ont. Sec. Com.); *Beer v. Townsgate I Ltd.*, [1995] O.J. No. 3009 (Ct. J. (Gen. Div.)); *First Federal Capital (Canada) Corp. (Re)* (2004), 27 OSCB 1603 (Ont. Sec. Com.); *First Federal Capital (Canada) Corp. (Re)* (2005), 28 OSCB 4391 (Ont. Sec. Com.); *St. John (Re)* (1998), 21 OSCB 3851 (Ont. Sec. Com.); *Revak v. SEC Realty Corp.*, 18 F.3d 81 (2nd Cir. 1994); *Glick v. Sokol*, 777 N.E.2d 315 (Ohio C.A. 2002); *Sec. Trust Corp. v. Estate of Fisher*, 797 N.E.2d 789 (Ind. C.A. 2003); *Allen v. Jones*, 604 S.E.2d 644 (Ga. C.A. 2004); *Superintendent of Financial Services and OSC v. Universal Settlements International, Inc.* (2001), 24 OSCB 7299 (Sup. Ct.); *Superintendent of Financial Services and OSC v. Universal Settlements International, Inc.* (2001), 24 OSCB 7303 (Sup. Ct.); *Universal Settlements Inc., Tony Duscio and Derek O'Brien v. Superintendent of Financial Services* (14 January 2002), Toronto I0151-2001 (Financial Services Tribunal); *Universal Settlements International Inc.* (2003), 26 OSCB 1307 (Ont. Sec. Com.); *Universal Settlements International Inc.* (2003), 170 O.A.C. 24 (Ont. Div. Ct.); *Universal Settlements International Inc.* (2003), 67 O.R. (3d) 670 (Div. Ct.); *Universal Settlements International Inc. v. Ontario Securities Commission.* (12 March 2004), Toronto M30604 (Ont. C.A.).

[74] There are no Canadian cases dealing with the issue of whether schemes for investment in viaticals are investment contracts. Accordingly, it is appropriate to consider U.S. cases on this issue.

Pacific Coast

[75] *Pacific Coast Coin Exchange of Canada Ltd. v. Ontario (Securities Commission)* (1977), 80 D.L.R. (3d) 529 (S.C.C.) is the leading Canadian authority on the meaning of investment contract under the Act.

[76] In *Pacific Coast*, the promoter of a scheme sold bags of silver coins on margin for future delivery. Investors had the option of taking delivery in specie on payment in full or of closing out the contract by reselling the bags of silver coins back to the promoter at the market price for silver. Funds paid by investors were commingled with the assets of the promoter and no bags of silver coins were segregated for possible delivery on the contracts. Performance of the

obligations of the promoter to deliver bags of silver coins on payment in full or to pay any increase in value when the bags were sold back to the promoter was subject to the credit worthiness of the promoter.

[77] The promoter argued that profits came from changes in the value of silver as determined by the market. The court held that the investor's expectation of profit was governed not only by the silver market but also by the promoter's internal market for silver and that the amount of the investor's profit depended for practical purposes on the efforts of the promoter. Although the commodity contracts were not themselves investment contracts, the relationship between the company and its investors created an investment contract within the meaning of the Act.

[78] The customer obtained no specific interest in any particular bag of silver until he paid for it in full and accepted delivery. The company obtained title to the funds paid by the margin account customers as a deposit. The court observed that until the investor paid the full purchase price, he had no title to any physical property, but only a claim against the company. The court stated, however,

> This is not to say that we are looking at a pure question of solvency… the conclusion of the Divisional Court does not rest on such a narrow basis. (p. 541)

[79] The court stated that leading U.S. authorities could assist Canadian courts in interpreting the meaning of investment contract. The court also stated that the Act is remedial and meant to be construed broadly in a manner that fulfills its statutory purposes, which include the protection of investors. Accordingly, courts and tribunals must broadly interpret the meaning of investment contract.

[80] The court adopted, with modification, the U.S. approach to investment contracts set out in *Howey* and held that a scheme will constitute an investment contract where there is: (i) an investment of funds with a view to profit; (ii) in a common enterprise; (iii) where the profits are derived from the undeniably significant efforts of persons other than the investors.

[81] The court quoted with approval the statement in *Tchereprin v. Knight* (1967), 389 U.S. 332 at p. 336:

> … in searching for the meaning and scope of the word "security" in the Act, form should be disregarded for substance and emphasis should be on economic reality. (p. 538)

[82] The court agreed with the court in *Howey*, which stated that any definition must permit

> … the fulfillment of the statutory purpose of compelling full and fair disclosure relative to the issuance of "the many types of instruments that in our commercial world fall within the ordinary concept of a security." … It embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits. (p. 299)

[83] The court also looked at the risk capital test in *State of Hawaii, Commissioner of Securities v. Hawaii Market Center, Inc.*, 485 P.2d 105 (Hawaii Sup. Ct. 1971) and came to the

same conclusion under that test.

[84] The court also adopted the test in *SEC v. Glen W. Turner Enterprises, Inc.*, 474 F. 2d 476 (9th Cir. 1973) that the expression "common enterprise" means "one in which the fortunes of the investors are interwoven with and dependent upon the efforts and success of those seeking the investment of third parties."

[85] In the court's view, a common enterprise exists

> … when it is undertaken for the benefit of the supplier of capital (the investor) and of those who solicit the capital (the promoter). In this relationship, the investor's role is limited to the advancement of money, the managerial control over the success of the enterprise being that of the promoter; therein lies the community. In other words, the 'commonality' necessary for an investment contract is that between the investor and the promoter. There is no need for the enterprise to be common to the investors between themselves. (p. 540) …
>
> The key to the success of the venture is the efforts of the promoter alone, for a benefit will accrue to both the investor and the promoter. (p. 541)

[86] This test is broader than the *Howey* test where some form of commonality among investors is required. However, the court said at p.542,

> At the invitation of the parties, I have examined the facts in the sole light of the *Howey* and *Hawaii* tests. Like the Divisional Court, however, I would be inclined to take a broader approach. It is clearly legislative policy to replace the harshness of *caveat emptor* in security related transactions and Courts should seek to attain that goal even if tests carefully formulated in prior cases prove ineffective and must continually be broadened in scope. It is the policy and not the subsequently formulated judicial test that is decisive.

[87] The broader approach preferred by the Divisional Court in *Pacific Coast*, referred to with approval by the Supreme Court, is reflected in this passage from the judgment of Houlden, J. at pp. 347-9 (55 D.L.R. (3d) 331):

> Although I have dealt with the meaning of "investment contract" as it has been interpreted by the Courts of the United States, I would have preferred to have given the words a much wider meaning. In my opinion, the tests propounded in the American Courts are too rigid and restrictive and if literally applied could defeat the purpose of securities legislation, i.e., "the protection of the investing public through full, true and plain disclosure of all the material facts relating to the securities being issued": Re Ontario Securities Commission and Brigadoon Scotch Distributors (Canada) Ltd. [1970] 3 O.R. 714 at p. 717, 14 D.L.R. (3d) 67 at p. 77, 3 C.C.C. (2d) 463, [1971] 3 W.W.R. 133, an investment contract is "one which provides for investment". And then quoting from Stout, C.J., in Com'r of Taxes v. Australia Mutual Provident Society (1903) 22 N.Z.L.R. 445 at p. 450, he defined investment as the putting of money". This definition accords with the much simpler definition given by Murphy, J., in the Howey case, supra, p. 208, where, after referring to certain decisions of State Courts, he said: "An investment contract thus came to mean a contract for 'the placing of capital or the laying out of money in a way intended to

> secure income or profit from its employment'." If this were the test of what constitutes an investment contract, then adopting the words of Murphy, J., in the Howey case, form can be disregarded for substance and emphasis placed upon economic reality. When "investment contract" is given this interpretation, it undoubtedly casts a wide net, but the Court can narrow its sweep by applying the test of economic reality.

Howey

[88] In *Howey*, a promoter sold to investors units of interests in a citrus grove development coupled with a contract for cultivating, marketing and remitting the net proceeds to the investor. The promoter planted about 500 acres annually, keeping half the groves for itself and offering the other half to the public "to help us finance additional development". About 85% of groves sold were covered by service contracts with the promoter. The court found that the arrangement constituted an investment contract, and therefore a security, under the U.S. Securities Act of 1933.

[89] The court rejected the suggestion that there was no investment contract because the tangible interest that was sold had intrinsic value independent of the success of the enterprise as a whole. If the test for an investment contract is met, it does not matter if there is also a sale of property with intrinsic value.

Hawaii

[90] In *Hawaii*, investors did not participate in the profits of the business enterprise. They were promised fixed fees and commissions that were payable regardless of the existence of profits. The court said at p. 110,

> It should be irrelevant to the protective policies of securities laws that the inducements leading an investor to risk his initial investment are founded on promises of fixed returns rather than a share of profits. The reference point should be the offeree's expectations, not the balance sheet of the offeror's corporation. The unwary investor lured by the promise of fixed fees deserves the same protection as a participant in a profit sharing plan. For this reason, courts have avoided a narrow definition of profits.

[91] In our case, investors do not participate in the profits of the business enterprise of USI but are promised fixed returns on their investments that, on an annualized basis, will be more or less profitable depending on the period of time funds are deployed in the common enterprise. The investors furnish the capital that is deployed to purchase viaticals in the common enterprise and that is the source of the fees and income of USI and its agents from the common enterprise.

[92] In *Hawaii*, the court stated at p.111 that "to negate the finding of a security the [investor] should have practical and actual control over the managerial decisions of the enterprise. For it is this control which gives the [investor] the opportunity to safeguard his own investment, thus

obviating the need for state intervention." Investors in the USI viatical offering cannot exercise any such managerial control over their investment.

Life Partners

[93] In *Securities and Exchange Commission v. Life Partners, Inc.*, 87 F.3d 536 (D.C. Cir. 1996), the United States Court of Appeals for the District of Columbia found that a scheme for the sale of viaticals to investors by Life Partners International (LPI) resulted in sufficient commonality in which there was an investment of funds for profit. However, Justice Ginsburg, speaking for the majority of the court, found that the profits in the investment did not come predominantly from the efforts of persons other than the investors. Justice Wald dissented on this issue.

[94] In *Life Partners*, LPI offered fractional interests in viaticals. LPI performed many of the tasks that USI performs for its investors. However, unlike in our case, viaticals and viators were found and scrutinized by LPI before investors were assembled or paid their funds to LPI. Thus, in *Life Partners*, LPI evaluated the viator's medical condition, reviewed the life insurance policy, negotiated the purchase price and prepared the legal documentation before the investor made his investment decisions.

[95] Investors in *Life Partners* were not obliged to use the services of LPI to perform post-acquisition administrative activities which were offered as an administrative convenience to take or to leave. In fact, LPI furnished investors with all of the information needed to handle post-purchase activities. In a later version of the scheme, LPI offered no post-purchase activities on behalf of investors. They were the responsibility of investors, although investors could contact the trust and contract with it to perform the services.

[96] The court found "commonality" in *Life Partners* because an investor depended on other investors to be found to aggregate sufficient funds to acquire a viatical. Justice Ginsburg stated at p. 544,

> Because LPI's viatical settlements entail this implicit form of pooling, and because any profits or losses accrue to all investors (in proportion to the amount invested), we conclude that all three elements of horizontal commonality – pooling, profit sharing, and loss sharing – attend the purchase of fractional interests through LPI. (We need not reach, therefore, the SEC's alternate contention that the LPI program entails "strict vertical commonality" – another formulation of the common enterprise test recognized in some circuits.)

[97] LPI structured purchases of viaticals through a trust established for that purpose and investors' funds and payments for investors went through the trust and not LPI itself. Thus the funds from investors were not commingled with the funds of LPI. Justice Ginsburg held at p. 544 that "it is the inter-dependency of the investors that transforms the transaction substantively into a pooled investment" and that "if the investments are inter-dependent it would not matter if LPI scrupulously avoided commingling investors' funds – for example by passing [investor] checks directly to the seller at closing." We concluded that in our case it is not necessary that the

capital or assets employed in the common enterprise also become capital and assets of USI, subject to its solvency risk, before we can find an investment contract.

[98] Justice Ginsburg held that just because there was "commonality" did not mean, *ipso facto*, that there was an "enterprise". That would depend, Justice Ginsburg held, on the answer to the third prong of the *Howey* test, namely, whether profits are expected to arise from the efforts of others.

[99] Justice Ginsburg held at p.547 that

> LPI's pre-purchase efforts were 'undeniably essential to the overall success of an investor's investment'. The investors rely heavily, if not exclusively, upon LPI to locate insureds and to evaluate them as well as to negotiate an attractive purchase price."

[100] However, because these activities occurred pre-purchase, Justice Ginsburg held, the value of the promoter's effort had already been impounded into the promoter's fees or into the purchase price of the investment, and if neither the promoter nor anyone else was expected to make further efforts that would affect the outcome of the investment, then the need for securities regulation was greatly reduced. He doubted that pre-purchase services should ever count for much.

[101] Justice Ginsburg held at p.545 that "post-purchase entrepreneurial activities are the 'efforts of others' most obviously relevant to the question of whether a promoter is selling a security…"

[102] Justice Ginsburg concluded that the combination of LPI's pre-purchase services as a finder-promoter and its largely ministerial post-purchase services were not enough to establish that the investor's profits flow predominantly from the effort of others. We believe that this conclusion is inconsistent with the finding that the pre-purchase activities were undeniably essential to the overall success of an investor's investment.

[103] In a strong dissent, Justice Wald held that where profits depend on the success of the promoter's activities, there is less access to key information, i.e., that specific to the promoter. The investor needs to know the risk factors attached to the investment and whether there is any reason why the investor should be leery of the promoter's promises. This need for information holds true for investors prior to purchase as much as for investors who have committed their funds. Justice Wald held that an artificial line should not be drawn between pre-purchase and post-purchase activities. To do so, Justice Wald held, elevates a formal element, timing, over the economic reality of the investors' dependence on the promoter, and undercuts the flexibility and ability to adapt to "the countless and variable schemes" that are the hallmarks of the *Howey* test.

[104] In our case, most, if not all, of the pre-purchase activities in *Life Partners*, occur after an investor makes his investment by paying the committed amount and signing the purchase agreement. Those activities in *Life Partners* that occurred before investors were assembled, occur in our case, after they are assembled.

[105] While Justice Ginsburg acknowledged that it is the length of the viator's life that is of

overwhelming importance to the value of the viatical settlements marketed by LPI, Justice Wald emphasized that the realization of expected investor profits depended not on the timing of the viator's death per se but rather on whether the death occurred within the period estimated by LPI.

Mutual Benefits

[106] In *Securities and Exchange Commission v. Mutual Benefits Corp.*, 408 F.3d 737 (11th Cir. 2005) the U.S. Court of Appeals for the 11^{th} Circuit held that viatical settlement contracts sold by Mutual Benefits Corp. (MBC) were investment contracts.

[107] The facts in *Mutual Benefits* were similar to those in *Life Partners*. However, MBC required investors to deposit the purchase price of the investment with an escrow agent before MBC selected a policy that fit the investment goals of the individual investors, based on the price the investor wanted to pay and the life-expectancy period that the investor desired. MBC granted varying rights to withdraw the deposit (3 to 7 days from the date of deposit) and thereafter the investor could not back out of the agreement. The investor could reject a proposed viatical, and MBC could then attempt to locate and propose another. Fractional interests were offered.

[108] There was no dispute in *Mutual Benefits* that there was an investment of money with a view to profits. The court found that the investment scheme involved both horizontal commonality, in that investors' money was typically pooled to invest in a viatical, and investors shared both the promise of profits and the risk of loss. Thus, there was a "common enterprise".

[109] The real issue in *Mutual Benefits* was whether the investor's expectation of profits was based solely on the efforts of the promoter or a third party. MBC relied on *Life Partners*. The court, however, specifically declined to adopt the test on this issue set forth in *Life Partners*.

[110] The court agreed with the dissenting opinion of Justice Wald in *Life Partners* that significant pre-purchase managerial activities undertaken to insure the success of the investment may also satisfy the third prong of the *Howey* test. The court stated at pp.744-45,

> The investors' expectations of profits in this case relied heavily on the pre- and post-payment efforts of the promoters in making investments in viatical settlement contracts profitable. The investors selected the "term" of their investment, and submitted completed agreement forms and money. Thereafter, MBC selected the insurance policies in which the investors' money would be placed. MBC bid on policies and negotiated purchase prices with the insureds. MBC undertook to evaluate the life expectancy of the insured – evaluations critical to the success of the venture. If MBC underestimated the insureds' life expectancy, the chances increased that the investors would realize less of a profit, or no profit at all. And, investors had no ability to assess the accuracy of representations being made by MBC or the accuracy of the life-expectancy evaluations. They could not, by reference to market trends, independently assess the prospective value of their investments in MBC's viatical settlement contracts. There were important post-purchase managerial efforts of MBC as well. Often, life-expectancy evaluations were not completed until after closing. And, after closing on a policy, MBC assumed the responsibility of making premium payments. Escrow payments were collectively managed in such a manner

> that investors were not required to pay additional premiums. Thus, investors relied on both the pre- and post-purchase management activities of MBC to maximize the profit potential of investing in viatical settlement contracts. …
>
> The investors here relied on MBC to identify terminally ill insureds, negotiate purchase prices, pay premiums, and perform life expectancy evaluations critical to the success of the venture. The flexible test we are instructed to apply by Howey and Edwards covers these activities, qualifying MBC's viatical settlement contracts as "investment contracts" under the Securities Acts of 1933 and 1934.

[111] We have two conflicting cases of the U.S. Court of Appeals (*Life Partners* and *Mutual Benefits*) on the third prong of the *Howey* test. While we are not bound to follow U.S. cases, we are of the opinion that *Mutual Benefits* and Justice Wald's dissenting opinion in *Life Partners* are correct and reflect the economic reality and flexible approach endorsed by the Supreme Court of Canada in *Pacific Coast*. Furthermore, we are troubled by the inconsistency in the reasoning of the majority opinion in *Life Partners*. Even so, the facts in our case are sufficiently different from those in *Life Partners* – many of the pre-purchase activities that the majority in *Life Partners* described as "undeniably essential to the overall success of the investment" are post-purchase activities in our case [i.e., they occur after the assembling of investors and after the commitment of funds] – that based on *Life Partners* alone, we could find that USI's viatical products are investment contracts.

Siporin

[112] In *Siporin v. Carrington*, 23 P.3d 92 (Ariz. C.A. 2001), the Court of Appeals of Arizona held that the viatical settlements in question were securities under the Arizona Securities Act. The court found that the investor's profit realization on a viatical settlement depends on the price paid for the interest and the amount of time that passes between the purchase and the viator's death.

[113] The court disagreed with *Life Partners* and, not being bound by the federal Court of Appeals' interpretation of the U.S. federal statutes, and purporting to follow *Howey*, found that the profits investors' expected to realize depended almost entirely on the promoter's expertise in choosing which viaticals to purchase. This in turn depended entirely on the promoter's entrepreneurial and managerial skills. The court stated at p.97,

> In selecting life insurance policies to "viaticate," Carrington had to estimate the life expectancy of each prospective viator, which entailed reviewing medical records, gauging the truthfulness of the prospective viator's representation of his or her condition, and obtaining expert assistance to evaluate the prospective viator's medical condition. Carrington also had to review all potentially available medical treatments that might affect the prospective viator's life expectancy. More importantly, Carrington also obligated itself to investigate the prospective viator's life insurance policy to determine the actual death benefit payable and the likelihood that it would actually be paid in full. To do so, Carrington had to ensure that the policy was not contestable on any ground; that it was assignable; that it was not a group policy subject to cancellation with limited or nonexistent conversion rights;

> and that the insurance company's financial condition was such that it would be able to pay the death benefit when due.
>
> Once Carrington had completed its analysis, it negotiated an advantageous price at which it would purchase the prospective viator's life insurance policy. Thereafter, Carrington marketed fractional interests in the policy to the general public, and it undertook premium payment and monitoring services to keep the policy in force and to timely claim the death benefit on behalf of the investors. Although it is the viator's death that ultimately yields a return, the profitability of the return depends almost exclusively on the viatical seller's entrepreneurial pre-closing investigations, analyses, and negotiations in selecting the viator and the policy and in setting the terms on which the policy is purchased.

[114] The efforts USI undertakes on its investors' behalf are similar to those undertaken by the promoter in *Siporin*.

[115] The court disagreed with the statement in *Life Partners* that investors' profits from viatical settlements "depend entirely upon the mortality of the insured" and that in such a situation, a potential investor's "need for federal securities regulation is greatly diminished." On the contrary, the court in *Siporin* held at p. 99,

> The mortality of the viator is merely another factor to be considered when the seller assembles a viatical settlement agreement that will, the parties hope, be profitable for the investor upon the inevitable death of a viator. What truly determines viatical settlement profitability is the realization, over time, of an outcome predicted by the seller through its analyses of the viator's life expectancy, the soundness of the insurer, the actions needed to keep the policy in effect for the original face amount, and the insurer's unconditional liability under the policy's terms.

[116] We agree with this statement.

Lazerman

[117] *British Columbia (Superintendent of Brokers) v. Lazerman Investment Metals International Inc.*, [1985] B.C.J. No. 2338 (C.A.) concerned client account agreements for the purchase of precious metals and involved deposits of funds by clients in a segregated bank account and hedging contracts for the benefit of the customers. The British Columbia Securities Commission and the court agreed that the client account agreements were not investment contracts. The court observed that the company did not solicit or require venture capital from its customers. Their deposits were segregated from and not used as part of the company's capital or operating funds. The segregated moneys and hedged contracts purchased with them were held in trust for the customers. The Commission and the court found there was no common enterprise.

[118] The facts in *Lazerman* were quite different from the facts in our case. Further, *Life Partners* and *Mutual Benefits* make it clear that the fact customers' moneys are segregated, or held in trust, or not commingled with the promoter's funds, is not determinative of whether a transactional relationship may constitute a common enterprise under the second prong of the test

in *Howey*.

Sisto

[119] In *R v. Sisto Finance NV*, [1994] O.J. No. 1184 (Ctr. J. (Prov. Div.)) the accused were charged under the Ontario Securities Act with trading and distributing investment contracts without complying with the Act. They were found guilty. The contracts were part of a scheme to raise funds from the public for the development of small placer gold mines in western North America without complying with the Act, by purporting to sell gold for future delivery at a discount from the current market price.

[120] The court stated at paras. 212 and 213,

> The basis on which the British Columbia Commission purported to distinguish the facts in the Lazerman case from the facts in Pacific Coast Coin is, quite frankly, not convincing.
>
> The decision of the B.C. Court of Appeals appears to be based on an acceptance of the findings of fact of the Commission, recognizing its "special expertise in the matter" (p. 310). Both the Commission and Court, however, applied the tests from the cases rigidly, an approach that I have rejected, and that I believe was rejected by the Ontario Courts and by the Supreme Court of Canada in the Pacific Coast Coin case.

[121] We agree with *Sisto*.

Other Cases

[122] While we considered the other cases referred to by counsel, we do not believe that a discussion of them is necessary or helpful to explain the reasons for our decision.

CONCLUSION

[123] Based on the facts, and consistent with the cases discussed above, we find that USI's relationship with its investors in GLS-II and GLS constitutes a common enterprise and that the profits of the common enterprise are derived from the undeniably significant efforts of USI and its agents. Accordingly, USI's viatical products are investment contracts, and, therefore securities under the Act.

Dated at Toronto, this 29th day of September, 2006

"Paul M. Moore"

Paul M. Moore, Q.C.

"Harold P. Hands"

Harold P. Hands

"Wendell S. Wigle"

Wendell S. Wigle, Q.C.