

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

CASE NO. 04-60573-CIV-MORENO/SIMONTON

SECURITIES AND EXCHANGE
COMMISSION,

Plaintiff,

v.

MUTUAL BENEFITS CORP.,
JOEL STEINGER a/k/a JOEL
STEINER, LESLIE STEINGER
a/k/a LESLIE STEINER,
PETER LOMBARDI,
and STEVEN K. STEINER,

Defendants,

VIATICAL BENEFACTORS, LLC,
VIATICAL SERVICES, INC.,
KENSINGTON MANAGEMENT, INC.
RAINY CONSULTING CORP.,
TWIN GROVES INVESTMENTS, INC.,
P.J.L. CONSULTING, INC.,
CAMDEN CONSULTING, INC.
and SKS CONSULTING, INC.

Relief Defendants.

SEVENTH REPORT OF THE RECEIVER

Roberto Martínez, court-appointed receiver (the "Receiver") of Mutual Benefits Corp. ("MBC"), Viatical Benefactors, LLC ("VBLLC"), Viatical Services, Inc. ("VSI"), and Anthony Livoti, Jr., P.A. and Anthony Livoti, Jr., solely in their capacity as trustee, all of which collectively are referred to as the "Receivership Entities," hereby submits his Seventh Report of the Receiver.

Colson Hicks Eidson

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PRELIMINARY STATEMENT

The principal work of the Receiver, in addition to participating as a party in the numerous litigation proceedings in this case and throughout the country, has been to actively manage the approximately 7,000 insurance policies involving 31,000 plus investors, with all of the attendant obligations and ramifications. That work has required the Receiver to employ a core workforce of employees at VSI and MBC to operate those entities and the engagement of several outside professionals to handle the numerous sophisticated legal, accounting, and tax issues unique to this receivership. Without the participation of these individuals the Receiver cannot effectively perform his obligations. The participation of these individuals necessarily requires that they be paid for their services.

The Receiver respectfully needs, once again, to bring to the Court's attention the critical shortage of operating funds available to administer the receivership. With the limited cash available at this time, the Receiver is unable fully to fund the administrative expenses. Some of the receivership professionals have not been paid in over a year, have significant outstanding approved unpaid fees and have pending fee applications through June 30, 2005. The Receiver can no longer ask these professionals to continue to work without payment. However, their work is essential to the administration of the receivership.

In sum, the work of administering this receivership is labor-intensive, as this is one of the largest receiverships ever sought by the S.E.C. in South Florida in terms of the number of affected investors and the amount of invested funds. The management of a portfolio of approximately 7,000 active insurance policies, with over 31,000 investors holding fractionalized interests in most policies, adds to the complexity of the various legal, financial and management issues.

The current shortage of funds makes the task of administering the receivership even more challenging and requires that immediate action be taken. A related issue is the immediate need to begin an orderly process for the disposition of the policies in order to avoid a lapse of those policies and a total loss of value. This need is made urgent due to the diminishing availability of funds to pay premiums.

The best solution at this time to address both of these concerns is to allow the Receiver, as provided in the Order Appointing Receiver, to use the funds held in the account styled "Premium Escrow Account" at Union Planters Bank, N.A. to pay the operating and administrative expenses of the receivership, including professional fees and expenses, subject to reimbursement of legitimately escrowed funds, if necessary, and, concurrently, to authorize the Receiver immediately to begin a process for the disposition of the policies currently administered by the Receiver.

The Receiver respectfully submits that this immediate relief is needed. As such, the Receiver urges the Court to act immediately to approve:

- the Receiver's Motion to Clarify Order Appointing Receiver Regarding Use of Funds in "Premium Escrow Accounts" [D.E. 857], dated March 5, 2005, which Motion was heard by this Court on June 23, 2005; the motion would authorize the use of the funds held in the account styled "Premium Escrow Account" at Union Planters Bank, N.A. to pay Receivership operating expenses, including professional fees and expenses, subject to the reimbursement provision of the Order Appointing Receiver; and,
- the Receiver's Motion to Approve Procedure for Disposition of Policies, Distribution of Proceeds of Policies and Treatment of Premium Funds" [D.E. 902], dated April 22,

2005 (the "Disposition Motion"), which Motion was also heard by this Court on June 23, 2005; the motion would authorize a process for the disposition of the policies currently administered by the Receiver.

In order to assist the Court in better understanding the options facing the receivership, the Receiver, in Part I of this Report, sets forth the reasons why bankruptcy is not currently a viable option, and in Part II of this Report, provides a description of the current operational functions of MBC and VSI.

PART I:

BANKRUPTCY IS NOT CURRENTLY A VIABLE OPTION.

This Report addresses in more detail the Receiver's analysis of why bankruptcy of any of the Receivership Entities is not in the best interests of the parties in this case, and indeed, why it would be detrimental.¹ This Report also describes three viatical cases involving issues somewhat similar to those presented in this case, and the manner in which the court and the court-appointed fiduciaries addressed those issues.

As will be discussed in detail below, bankruptcy is not currently a viable option for this case. It will complicate, not facilitate, the resolution of the assets administered by the Receiver. Moreover, bankruptcy is unnecessary; everything that could be accomplished in a bankruptcy can be accomplished more efficiently in the receivership. Resort to the bankruptcy courts under these circumstances would potentially render it impossible to fashion a remedy for the victims of this fraud. Finally, the structure of bankruptcy would

¹ Defendant Peter Lombardi has repeatedly suggested that this "case" should be placed into bankruptcy and, indeed, has appealed to the Eleventh Circuit this Court's denial of his motion for such authority. The Eleventh Circuit dismissed this interlocutory appeal for lack of jurisdiction, but Lombardi has filed a motion for rehearing *en banc*, which is currently pending.

make it impossible to fashion appropriate relief for the investors. At this juncture a bankruptcy case or cases would only increase administrative expenses without achieving any benefit either for the investors, other creditors, or even the entities themselves.

A. This "Case" Cannot Be In Bankruptcy.

Title 11 of the United States Code (the "Bankruptcy Code") imposes significant restrictions on the effectiveness, and even the availability, of bankruptcy relief under the circumstances of this case.

(i). Who May Be A "Debtor"?

This "case" cannot be placed into bankruptcy, because a bankruptcy case is the bankruptcy of a "debtor." 11 U.S.C. § 109 governs who may be a "debtor." There are currently five receivership entities – MBC, VSI, VBLLC, Anthony Livoti, Jr. as Trustee ("Livoti Trustee") and Anthony Livoti, Jr., P.A. as Trustee ("Livoti P.A. Trustee"). Two of these entities, Livoti Trustee and Livoti P.A. Trustee, cannot be debtors, since neither the P.A. nor the individual, solely in their capacity as trustee, can be a debtor. Only Livoti individually or the P.A. could be a debtor, and the Receiver does not have the authority to place either Mr. Livoti or his P.A. into bankruptcy; nor does there appear to a legitimate basis to do so.

Livoti Trustee or Livoti Trustee, P.A. own the vast majority of the insurance policies being administered by the Receiver. Because neither Livoti Trustee or Livoti Trustee, P.A. can be a debtor, the disposition of these policies would necessarily remain in this receivership case, unless the bankruptcy trustee of a debtor (presumably MBC) were able to demonstrate to the bankruptcy court the grounds upon which the bankruptcy trustee would be able to take control of the interests of Livoti Trustee and Livoti Trustee, P.A. in order to

administer the policy interests. The outcome of such a motion is not guaranteed, and it would cost money to litigate the issue. Conversely, in this case, the Court has ruled that Livoti P.A. as Trustee and Livoti individually as Trustee are receivership entities, giving the Receiver the responsibility and control over those assets that are assets of Livoti Trustee.

Thus, even if MBC, VSI and VBLLC were placed into bankruptcy, the Receiver would still likely need to administer the policies owned by Livoti Trustee and Livoti Trustee, P.A. in the receivership proceeding before this Court.

(ii). *"Types" of Bankruptcy.*

In order to determine whether and what kind of bankruptcy relief, if any, is appropriate, one must examine the purpose of the bankruptcy (including whether, and to what extent, a business can or should be reorganized) and the assets to be administered in the bankruptcy.

There are three types of bankruptcy for which MBC, VSI or VBLLC could be eligible – Chapter 11 reorganization, Chapter 11 liquidation or Chapter 7 liquidation. In Chapter 11, a debtor is eligible to be a debtor-in-possession, allowing it, rather than a trustee, to manage its bankruptcy case. For example, the management of a corporate debtor would remain in place after the filing of a Chapter 11 bankruptcy and would administer the bankruptcy on behalf of the creditors. Under certain circumstances, a Chapter 11 trustee may be appointed to take over the administration of the debtor's assets for the benefit of creditors.²

² Under the current Bankruptcy Code, while generally the office of the U.S. Trustee will appoint a trustee, the creditors have a right to elect a Chapter 11 trustee of their choice.

In order to exit Chapter 11, a debtor-in-possession, trustee, or other party in interest must file a plan,³ which plan must be sent to all creditors for voting. The manner in which a plan may propose to treat creditors over their objection ("cramdown") is outlined in Chapter 11. Creditors can consent to treatment that does not comply with the priority of distribution of the Bankruptcy Code, so long as they have been given notice and an opportunity to vote. In addition to satisfying certain voting requirements, the plan must independently satisfy other requirements for confirmation, all of which are set forth in 11 U.S.C. § 1129. In a Chapter 11 reorganization, the business of the debtor is reorganized; and in a Chapter 11 liquidation, the business is liquidated.⁴

In Chapter 7 liquidation, a trustee is appointed by the office of the U.S. Trustee. The treatment of creditors, including the priority of distribution, is governed entirely by the statutory scheme laid out in 11 U.S.C. § 726. Creditors do not vote on their treatment.

(iii). *The "Business" of the Receivership Entities.*

The only receivership entity that actually operates as an ongoing business is VSI. VSI performs policy servicing and tracking functions for all policies purchased by investors. These services are discussed in detail in Part II below, and include monitoring of group insurance policies, monitoring of individual policies, viator tracking and death benefit

3 The debtor has a certain period of time in which it has the exclusive right to file a bankruptcy plan, but once a trustee is appointed or the time expires, exclusivity terminates and any party in interest may file a plan.

4 Chapter 11 liquidations are generally used when the debtor or other plan proponent wants to take advantage of the flexibility provided by a plan to address distribution and treatment issues (subject, of course, to consent by the creditors or satisfaction of cramdown requirements), and provides the opportunity for release provisions, some of which create incentives to buyers of assets from a bankruptcy estate.

processing. VSI also currently assists the Receiver with investor relations. MBC is subject to cease and desist orders and a preliminary injunction and is not operating as an ongoing business as such; MBC's employees' ongoing functions are more in the nature of assisting the receivership functions. Finally, VBLLC does nothing, since its sole function prior to bankruptcy was to purchase policies in certain states where MBC was not licensed.

Thus, the only Receivership Entity with a business to reorganize is VSI. However, there is no reason to place VSI in bankruptcy at this time (if ever); indeed, as further discussed herein, putting VSI in bankruptcy could create costly complications to the investors. Despite Lombardi's argument that bankruptcy is necessary in order to "reorganize" MBC, as noted above, MBC has no business, as such, to reorganize. Nor is there any reason to liquidate either MBC or VBLLC in bankruptcy. Liquidation of these two entities can and should be handled in this proceeding.

(iv). **Property of the Estate.**

11 U.S.C. § 541 defines property of the estate (that is, property that is subject to administration in the bankruptcy and distribution to creditors) generally as "all legal or equitable interests of the debtor in property as of the commencement of the case."⁵

MBC's property consists of office equipment, a note receivable, interests in some policies as beneficiary, owner, or nominal beneficiary or owner, and litigation recoveries, and, as the Receiver has submitted previously, all of the funds currently held in the account at Union Planters Bank, N.A. styled the "premium escrow account."

⁵ There are certain additional provisions such as community property, future interest in property, proceeds, etc., most of which apply to individuals, as well as certain exceptions.

VBLLC's property consists of a few pieces of office furniture, and it is the owner or beneficiary of record on a limited number of policies. VBLLC may also have litigation recoveries.

VSI's property consists of some cash, some office equipment, a proprietary database and possibly some litigation recoveries.

B. Bankruptcy vs. Receivership.

Defendant Peter Lombardi has contended that the Receiver is improperly seeking to liquidate the MBC business outside of bankruptcy, that an equity receiver should not liquidate assets of a company in receivership, and that case law dictates that any liquidation should occur only in bankruptcy. These contentions are wrong. It is entirely appropriate for the Receiver to liquidate the assets of MBC, VBLLC and VSI in this proceeding. Moreover, the Receiver does not require a bankruptcy to resolve this case.

Many of the provisions of the Bankruptcy Code discussed above derive from prior bankruptcy law and from the common law of receiverships.⁶ Thus, for example, a receiver can operate a business, liquidate assets, sell assets free and clear of claims and liens, assume or terminate contracts, create a claims process, and propose and consummate a distribution plan.

⁶ Receiverships continue to be governed almost entirely by common law and the dictates of equity, while bankruptcy has become more of a creature of statute, albeit still with the general overlay of equitable principles.

(i). **An Equity Receiver Can Liquidate Assets.**

There is no general rule prohibiting the liquidation of assets, including the rejection of contracts, by an equity receiver. An equity receiver can sell assets free and clear of liens. In sum, there is no legal impediment in this proceeding to the mechanics of liquidation.

(ii). **An Equity Receiver can Propose and Administer a Claims Process.**

The briefs filed by Receiver's counsel cite many cases where the equity receiver has set up and administered a claims process with court approval. This Court has already presided over the creation of a claims process in connection with the return of the pre-purchase escrow funds. No one, including Lombardi, has disputed this Court's ability to direct the creation of a claims process.

The Bankruptcy Code and the Federal Rules of Bankruptcy Procedure have detailed procedures regarding the processing and allowance of claims. The Receiver can and will incorporate many of these concepts in proposing a claims procedure in this case.

(iii). **The Receiver Can Propose a Distribution Plan.**

The same cases cited by counsel illustrating a receiver's ability to liquidate assets also clearly demonstrate that the Receiver also has the authority to propose a plan of distribution. Such a plan would necessarily describe the manner in which allowed claims will be treated and assets distributed.

While equity, rather than the Bankruptcy Code, dictates and evaluates the structure and adequacy of a proposed receiver's distribution plan, the requirements of due process are the same. Notice to all parties and an opportunity to be heard are crucial in both instances. Thus, as the Receiver has previously stated, the planned disposition of the policies (the

structure of which will depend on the Court's ruling on the Disposition Motion) will be submitted to all creditors so that each will have an opportunity to be heard on the proposal.

C. **Putting Any Of The Receivership Entities in Bankruptcy Now Would Create An Administrative Nightmare And Likely Double The Cost Of Administering Assets.**

If all or any of the eligible Receivership Entities were put into bankruptcy, the result would be two courts with jurisdiction over like assets, a similar creditor body and potentially different fiduciaries. As such, the costs associated with seeking relief in two courts rather than one would consume investor funds as there would be two fiduciaries, each with his or her own set of fiduciary duties, seeking to administer the same assets, and not necessarily agreeing on the appropriate course of action. ⁷ Finally, the bankruptcy fiduciary would seek turnover of the premium funds for use on the same basis the Receiver has asserted that those funds are MBC assets in the Disposition Motion. If the bankruptcy fiduciary were successful, as the Receiver believes would be the case, the premium funds would be separated from the policies so that there would be no funds to keep alive policies administered in the Receivership while a disposition plan was implemented in the Receivership.

(i). **The Potential for Two Administrators.**

If MBC, VSI or VBLLC were placed into bankruptcy, the Receiver would be treated as a custodian of the assets of the bankruptcy. Under the Bankruptcy Code, the debtor-in-

⁷ Sometimes a coterminous bankruptcy and receivership can be used successfully together. In the case of Premium Sales Corporation (which preceded the amendment to the Bankruptcy Code that now allows creditor election of Chapter 11 Trustees) the bankruptcy was used for three entities to take advantage of certain provisions of the Bankruptcy Code. This division was made possible because the trustee and the receiver were the same, there were no common assets in each case, so division of jurisdiction over all issues was clear, and ultimately all creditors were treated the same, with the receivership plan folding into the bankruptcy plan. That is not possible in this case for the reasons outlined in this Report.

possession, or trustee, if a trustee were in place, may seek turnover of the assets administered by the Receiver to the debtor-in-possession or trustee. If the bankruptcy court found turnover was not appropriate, (under 11 U.S.C. § 543 turnover can be excused if the interest of creditors . . . would be better served by permitting a custodian to continue in possession, custody , or control of such property, . . .”) then the costs associated with filing the bankruptcy, and seeking turnover, would have been wasted.

Alternatively, if turnover was granted, then the bankruptcy trustee would administer those policies falling into the definition of property of the estate and the Receiver would administer the balance of the policies, those for which Livoti, Trustee or Livoti Trustee, P.A. is the owner. It is possible that the bankruptcy trustee would seek to assert control of the Livoti policies. It is also possible that, instead, the bankruptcy trustee would propose a different disposition plan than that approved by this Court with respect to the Livoti policies. There is no question that the bankruptcy trustee would seek control of the funds in the premium escrow account since the bankruptcy trustee, like the Receiver, needs funds to administer the bankruptcy. The ensuing, costly litigation could delay the disposition of the policies, and ultimately result in the lapsing of all policies as funds to pay premiums and costs of administration were frozen or diverted for what some might unkindly characterize as a “turf war.” At a minimum confusion would ensue.

(ii). *The Cost of Dual Claims Process.*

Another potential source of tension is the treatment of claims. Most of the creditors in the receivership case and the bankruptcy case will likely be the same, since the vast majority of creditors are those that are seeking some compensation for the perceived or

actual losses arising from the MBC-engineered viatical fiasco. Even if the administrator is the same in both cases, or the administrators agree on treatment, the cost of going through the duplicate claims review and approval will eat up funds in administrative costs.

(iii). **No Purpose Would Be Served by Putting Any Receivership Entity into Bankruptcy Now.**

VSI: The only Receivership Entity with a business that has potential as an ongoing business is VSI; indeed, as the Receiver noted in the Disposition Motion, the Receiver is hopeful that ultimately either the stock or the assets of VSI can be sold to generate additional funds to pay creditors' claims. After the disposition of the policies, the Receiver intends to review the status of the different Receivership Entities to determine whether bankruptcy for VSI would be an appropriate alternative. However, that decision is premature as there are too many unresolved (and potentially unknown) variables that could affect that decision. In the meantime, there is no point in putting VSI into bankruptcy now. The risk of loss of control of the administration of VSI would be dramatic, as VSI is the entity that substantially maintains and updates the critical data associated with the policies that will make the disposition of the policies possible.

VBLLC: VBLLC has no business left; indeed its very existence was as a limited use affiliate/subsidiary of MBC. The limited assets of VBLLC can be easily liquidated in the receivership; nothing is gained by putting this entity into bankruptcy for liquidation, especially in light of all the complications that could ensue, as more fully outlined above.

MBC: There is no purpose served in putting MBC in bankruptcy at this time. MBC has no ongoing business to reorganize. MBC's only business was as a viatical settlement provider, and it is now subject to cease and desist orders issue by the State of Florida and

several other states. Bankruptcy will not make those cease and desist orders disappear; the automatic stay provisions of the Bankruptcy Code do not apply to regulatory enforcement actions.

The only other business that MBC has ever performed (other than exerting total control over VSI and Livoti through Joel Steinger) is to monitor investor complaints, transfer beneficiaries, and assist in the process of claiming death benefits. Since MBC can no longer purchase policies, and since the Receiver will be disposing of the policies that MBC had formerly administered, there is no ongoing business, as such, to reorganize.⁸

The Receiver's cash assets are significantly diminished. There is an immediate need to begin an orderly process of disposition of the policies, to avoid, to the extent possible, a lapse of those policies and a total loss of value. With the limited cash available at this time, the Receiver is unable to fund the administrative expenses of the Receivership Entities other than the payment of salaries, rent and other ancillary expenses. Some of the Receivership professionals have not been paid in over a year, have significant outstanding approved unpaid fees and pending fee applications through June 30, 2005.

Putting any of the three statutorily eligible Receivership Entities into bankruptcy at this juncture would solve none of these issues. It would create havoc in determining the manner in which policies could or should be disposed; it would create issues regarding the administration of the policies and other assets; it would create ambiguity as to which court(s) would be required to act upon various case issues; and, most significantly in this currently

⁸ Even were the bankruptcy court to order transfer of administration of the MBC, Steinger and VBLLC policies to the trustee in an MBC bankruptcy, the Receiver would still control and administer all the Livoti policies, which make up the vast majority of the value of the policies.

cash strapped receivership, would create significantly higher administrative expenses than those the Receiver currently incurs.⁹

Once the Court rules on the framework for disposition, then the Receiver can address the framework for the claims process, including treatment, all of which proposals will be subject to notice and a hearing. At some point much later on, it might make sense to move one or all of MBC, VSI or VBLLC to a bankruptcy case. That moment, however, may never arrive, and it certainly has not arrived yet.

D. Alternative Resolutions In Viatical Cases.

A logical question then is, what will happen in this case? How does the Receiver intend to administer this case in this Court? Once the Court rules on the manner in which the Receiver may dispose of the policies, the Receiver will prepare and file with the Court: (a) a proposed notice procedure for disposition of the policies; (b) a proposed claims procedure; and, ultimately, (c) a proposed distribution plan.

Until the Court rules on the disposition issue the Receiver cannot create a framework for the evaluation and treatment of claims. For example, if the Court directs that all investors will have the opportunity to elect whether to take, and pay the costs of, any interest in a policy, or sell it, then, the notice procedure for disposition of policies will be somewhat uniform within the investor groups, and the claim process will focus on those election

⁹ Bankruptcy and receiverships do sometimes compliment each other. In the case of Premium Sales Corporation the court appointed SEC receiver, Harley Tropin, was permitted to put Premium Sales Corporation and two of its affiliates in bankruptcy. The ensuing success of both cases was due in large part to the nature of the assets being administered in each case (primarily just litigation assets), a claims process in the receivership that was treated entirely through the class action because the receivership primarily involved litigation assets, and most importantly, because Tropin was the chapter 11 trustee as well as the receiver, a result, because of the changes in the 1994 Bankruptcy Code regarding election of a chapter 11 trustee, can no longer be assured.

opportunities. Alternatively, if the Court authorizes the disposition of policies as requested in the Disposition Motion, then the Receiver will need to develop different notices for those investors holding irrevocable beneficial interests, and for all other investors. Moreover, the Receiver would need to develop a claims process that addresses these distinct treatments.

The Receiver intends to submit any proposed treatment of claims to the review of all parties in interest as well as ultimate approval of the Court. Once the process is approved, the Receiver, with the oversight either of the Court, a Magistrate Judge, or even a Special Master, can review claims so that the distribution of non-policy assets can go forward. Of course, as the Court knows, there are few non-policy assets now, but it is the Receiver's hope and expectation that the treatment of claims will be resolved prior to the time that non-policy assets are available for distribution so that there will be little or no delay between completion of the claims review process and the opportunity to at least make an interim distribution to creditors.

The Receiver has been reviewing other viatical cases and the manner in which receivers and courts in those cases have treated issues similar to those in this case. Although these cases have circumstances unique to their investments and creditors, each is illustrative of options for addressing these challenges.

Future First Financial Group, Inc., Case No CA02-1598, Circuit Court, Seventh Judicial Circuit, St. Johns, County, Florida. This is a state court conservatorship initiated by the State of Florida Department of Insurance. Future First Financial Group, Inc. was the record owner of approximately 2,858 viaticated insurance policies, the beneficial ownership in which had been sold to 9500 investors. Some investors (approximately 900 out of 9500) held irrevocable beneficial interests on the records of the insurance companies. As with most

of the policies in this case, there were numerous investors assigned to each policy, whether the interests were irrevocable or revocable. Apparently, the assignment of interests as revocable or irrevocable was random.

The state court conservator did not have the funds to maintain the premium payments on the policies (short term funding was provided by a private industry lender). The conservator determined that it was in the best interest of all the investors that the policies be sold rather than allow them to lapse. So the conservator sought court approval to sell all the policies, including those in which the investors held irrevocable interests.

The Court authorized the conservator to sell those policies for which the conservatorship entities were the owners of record and the investors were not irrevocable beneficiaries. The sale of the irrevocable interests was accomplished by providing notice, as the Receiver intends to do in this case, to all those investors holding irrevocable beneficial interests. The notice, a copy of which is attached to this report as Exhibit "A", outlined the status of the case, and the options available to the investors – the investors could assign their irrevocable interest to the conservator, the conservator would assign the interest to the investor (surcharging for premiums paid, waiver of any other claim to proceeds, and requiring multiple investors assigned to one policy to decide amongst themselves what to do), or allow the policy to lapse. The notice provided that in the case of multiple "owners" in a policy, the majority would rule.

After the first notice went out, a majority of those who responded voted to assign their irrevocable interests to the conservator. A second notice then went out advising those who had not voted that the conservator was going to seek Court authority to revoke their

irrevocable beneficiary status on the basis that the irrevocable beneficiary status was a random consequence of the viatical entities' random assignment of interests.

Ultimately the Court entered an order revoking those interests. The Court determined that these policies were assets of the conservatorship for purposes of exercising jurisdiction to consider and approve the disposition process, notwithstanding the irrevocable beneficiary status of certain investors, because all of the policies were owned by the entity in conservatorship.

In re Reliance Financial & Investment Group, Inc., Case No. 02-33249-BKC-PGH, etc., United States Bankruptcy Court, Southern District of Florida. This is a viatical fraud case administered in the bankruptcy court involving approximately 1050 policies and 2500 investors. The policies were owned by one of the debtor entities, but the beneficial interests were held by the investors. Early in the case the Trustee received the Court's permission to bill investors for the costs of maintaining policies, and received the Court's authority to use estate funds to pay premiums where the investors did not contribute.

In connection with a settlement with several large institutional investors, a copy of which Settlement Agreement is attached as Exhibit "B," the Trustee filed a Motion for Order Authorizing (i) Procedures for Servicing Policies and Extinguishing Beneficial Interests for Non-Payment of Premiums and Service Fees (ii) Reduction of Beneficial Interests to Account for Debtors' Beneficial Interests, and (iii) Binding those persons not Parties to the April 10, 2003 Settlement Agreement to the Terms Concerning their Rights and Interests in Certain Life Insurance Policies. A copy of the Motion and Order are attached as Composite Exhibit "C".

The Court authorized the trustee to sell the policies, if a buyer could be found, and otherwise gave the trustee authority to: (a) continue to charge investors for premiums; (b) allow the trustee to auction the interests of investors who did not pay the costs of administration; and (c) if the interest were not sold at auction and the trustee could not reduce the policy to eliminate the interest (and the premium obligation) the Trustee could assume ownership of the interest or abandon the policy.

Dedicated Resources Inc and Dedicated Trust, Inc., Case No.: 01-36036-037-BKC-PGH, is another bankruptcy involving a viatical provider. In this case, the debtors were the original and subsequent owners of the viaticated insurance policies. All of the investors held irrevocable beneficial interests. Through a bankruptcy plan the debtors created a trust to which ownership of the policies were transferred. The Trustee was given the authority to assess each beneficiary the premium costs and an annual administration fee. The Trustee also has the authority to assess past due premiums. The failure to pay the costs and fees results in the forfeiture of the beneficial interest. The Trustee may then offer the interest first, pro rata to other investors in the same policy, then to other investors who have expressed an interest in purchasing fractional interests in other policies, then to an outside third party. If all else fails, the policy will lapse. A copy of the Trust Agreement is attached as Exhibit "D".

E. Conclusion.

Thus, in each case the Conservator, Trustee or Debtors in Possession determined that in most cases it would be in the best interest of all creditors that their interests in policies be sold, or alternatively that, where those interests could not be sold, the cost of maintaining and administering the policies would be transferred to the investors seeking an interest in those

policies with loss of the interest, or lapse of the policy, as the outcome where an investor did not pay. The manner in which that administration would occur varied in each case – the investors needed to work it out, the bankruptcy trustee would do it, the interests would be transferred to a grantor trust – but each proposal had an ultimate resolution that transferred the responsibility for administering and maintaining the cost of policies from the limited resources of the estates in which the interests were at least nominally held.

Once the Court rules on the Disposition Motion, the Receiver will be able to propose a mechanism to effectuate the sale or transfer of the policy interests. That mechanism will be submitted to the Court for preliminary approval, and then sent out to all investors for objection and comment.

PART II:

MBC's AND VSI's ONGOING OPERATIONS.

The Receivership Entities of MBC and VSI both continue to perform operational functions that are for the benefit of the investors and that are necessary to protect the assets of the receivership.

A. MBC.

MBC's post-receivership responsibilities include (i) policy maintenance, (ii) investor relations, (iii) financial administration and (iv) legal administration for both MBC and VSI. MBC has 11 full time employees and one part-time employee reduced from a pre-receivership total of over 80 employees. This includes one Operational Representative of the Receiver to oversee MBC's operations. That individual is an experienced former financial officer who reports directly to the Receiver on all operations of MBC and, importantly, performs all financial administration for both MBC and VSI.

(i). **Policy Maintenance.**

MBC currently employs five full-time clerical employees and one part-time clerical employee to handle the policy maintenance section. There are two separate functions performed by MBC regarding policy maintenance: policy changes and project maintenance.

Policy Changes. Policy changes are required to maintain an accurate database regarding the over 31,000 investors. This work is labor-intensive and voluminous, primarily requiring the processing of beneficiary change requests, Retirement Accounts/IRA mandatory distributions, and investor address changes. Beneficiary changes are requested by investors for many reasons, including deaths, divorces and assignments due to financial judgments. MBC also processes IRA beneficiary changes to meet Federal IRA mandatory distributions for investors who purchased investments through their IRAs. Trusts (Revocable Living Trusts and other Family Trusts) also often request beneficiary changes for successor Trustees or termination of such trusts. The address change requests are necessary to ensure the Receiver can provide notice to the investors (e.g., for the Union Planters Distribution, responding to inquiries and for future Receivership needs).

There are three main steps performed prior to effectuating a beneficiary or address change: (1) Document Collection: The required evidence is requested from investors after written requests are received. This may include obtaining certified death certificates, letters of administration, Last Will and Testaments, properly executed assignments and recorded judgments, divorce decrees, name change judgments, trust documents and IRA re-register and transfer statements. (2) Carrier Beneficiary Change Requirements: In order to perfect a beneficiary change on policies where there are irrevocable and non-nominal beneficiaries, some carriers require notices and releases to be mailed to all beneficiaries of record who

must execute the releases required by insurance carriers to perform any changes. This is oftentimes a monumental undertaking involving sending releases to several hundred investors all over the world. Once the releases are received they are forwarded for recording at the carriers. In addition, the IRA mandatory distribution requests are calculated prior to submission to the carriers. (3) Database Updates and Calculations: Finally, the insurance carriers return confirmations of address and beneficiary changes, which are then verified for correctness. The confirmed changes are then recorded into the MBC investor database. Any IRA distributions are then confirmed, prior to the final update.

Project Maintenance. There are occasions when project maintenance is required for receivership compliance with judicial proceedings. For example, project maintenance has entailed investigative reconciliation services for unidentified wires that remain in Union Planters ("UPBNA") bank accounts for fund disbursement to investors.

(ii). **Investor Relations.**

There are daily written requests received by the Receivership from regulatory agencies, attorneys, brokers, agents and, most importantly, the 31,000 plus investors. In an effort to assist investors and minimize concerns over the status of their investments, a combined MBC and VSI database was created to provide investors with a status summary. The status summary provides assurances that MBC's records list their correct information and also provides a status of the VSI insured/viator tracking. Every investor inquiry receives a status report describing this information. Since taking over investor relations from Garden City Group and Colson Hicks Eidson, the MBC investor relations section has received and responded to over 5,000 written requests since mid-March 2005. Again, this work is labor-intensive and time consuming.

The following steps were instituted at MBC to effectively handle investor inquiries:

- All correspondence and e-mails are immediately logged into a database created to monitor response time, use as a search tool for repeat requests/issues, solve problems, and monitor employee production.
- A status/action sheet is attached to the correspondence and marked for appropriate action (address change, beneficiary change, status request, Union Planters issues and Death Proceed requests) and then routed to designated employees responsible for responding for handling such requests.
- The reviewing section then marks the action requests and separates them into the following categories: (i) First Requests, (ii) Second, Third Requests (receives priority); (iii) Spanish Requests; (iv) Requests with phone numbers and emails, and (v) Investors with extraordinary concern or worries.

There are four investor relations personnel responsible for these functions.

"Second/Third Requests" are investigated and responded to immediately. The Spanish requests are translated and then routed for processing. Those requests with phone numbers are called, as are those expressing great concern, and then are routed for processing of a status summary report of their investment. The death proceed inquiries are forwarded to VSI employees for handling.

(iii). **Financial Administration.**

The Receiver's MBC Operational Representative performs the following financial administration responsibilities.

Premium Payment and Due Diligence. MBC performs accounting services for all premiums payable on the MBC viatical portfolio at the instruction of VSI. MBC also handles all banking related obligations for the payment of premiums and performs additional due diligence to verify the accuracy of payment requests. Through July 31, 2005, MBC has issued 8,022 checks for the payment of premiums totaling \$41,636,384

Operational Accounting and Treasury for both MBC and VSI. This includes budgeting, the transfer of funds, check signing, compilation of adjusting journal entries and assisting in the preparation of financial statements

General Bookkeeping. MBC performs general bookkeeping duties including posting vendor invoices and scheduled insurance premiums, generating checks, and making bank deposits for both MBC and VSI.

(iv). **Legal Administration.**

Finally, the Receiver has employed one salaried staff counsel at MBC to reduce legal expenses associated with the many operational legal issues of the receivership. The staff counsel is responsible for the following:

Licensing and Reporting. MBC staff counsel performs all functions associated with the withdrawal of licenses from the various states, including audits, tax matters, annual filings and other compliance issues. In those states that refuse to allow the withdrawal of the licenses (mostly due to investor complaints, regulatory actions or tax related matters), the staff counsel insures that all necessary filings are effectuated.

State Regulatory Matters. MBC staff counsel responds to the agency inquiries served on MBC from various state regulatory agencies.

Document Repository. MBC staff counsel assists in responding to subpoenas served on MBC as a result of Federal, State and administrative actions, including the SEC, the Attorney General, and various state regulatory and administrative actions, and assists in overseeing and implementing the responses to discovery requests and access to MBC documents.

B. VSI.

VSI continues to perform services comparable to the work it performed prior to the receivership. Specifically, VSI performs policy servicing and tracking functions for all policies purchased by investors in the viatical investments sold by and through MBC. The Receiver has hired an Operational Representative who oversees VSI's operations and reports directly to the Receiver. The Operational Representative has over five years of prior service to a Federal Trustee appointed in another viatical company shut down for fraud and has prior working knowledge of all aspects of the viatical servicing business. VSI has one employee with over 25 years of experience in the insurance industry and who has been employed by VSI since inception (pre-receivership). VSI also has 13 full-time employees and 1 part-time employee whose services are divided into four sections: (i) Premium Tracking; (ii) Viator Tracking; (iii) Death Benefit Processing; and (iv) Investor Relations.

(i). Premium Tracking.

Premium tracking is organized into Group and Individual policies.

The **Group Section** keeps track of the premiums for group insurance policies, mostly consisting of policies taken out by employees through their employer or through a group association (e.g., Nursing Associations, Bar Associations). There are currently 580 active group insurance policies. This section tracks the payment of premiums and the status of viators by performing the following:

- **Verifications of Employment.** VSI verifies the employment status of the insured via employer administrators, human resource hotlines, and/or the Internet sites set up by large corporations or other administrators and carriers. This is important for many reasons. For instance, should a viator change employers, there is a thirty-day time limit to convert the group policy to an individual policy. If the policy is not converted timely, the policy is in jeopardy of being lost.

- **Waiver of Premium Claims.** Annual recertification forms are obtained from insurance carriers and forwarded to viators for completion, which forms are then returned to the carriers for waiver continuation approval. These forms often require the viator's doctor to complete a physician's statement of eligibility. If the viators are not tracked and the forms not returned by the viators or otherwise not timely resubmitted to the carriers, the waiver becomes in jeopardy of being revoked. There would then be a 30-day time limit for conversion to an individual policy or the group coverage would be lost.

- **Long Term Disability Claims ("LTD").** Annual recertification is performed to confirm that the viator may covered on the LTD. By tracking the status of a claim through employer or LTD carrier, VSI is able to determine continued coverage. Should the LTD coverage terminate, basic life insurance coverage would cease, and a 30-day conversion period would then be applicable.

- **Leave of Absences.** Viators on leave of absences are tracked by contacting their employers every four to six months, and Internet resources are searched once a month. Likewise, should Leave of Absence end, a 30-day conversion period would also be applicable.

- **Premium Reimbursements.** Viators are reimbursed after obtaining proof that the premium was paid through payroll deductions. There are other viators that are retired and whose premiums are deducted from their annuities. These annuity statements are received and processed and reimbursements are then issued. Approximately 565 checks for reimbursements are sent each month to viators.

The Group Section provides the above services to ensure that (a) the coverage remains in place and/or conversion procedures are instituted; (b) waivers and disability coverage remains in place to limit costs for premiums; and (c) viators are reimbursed for their expenses when deducted through payroll or annuities.

The **Individual Section** performs policy and premium tracking services for the balance of the MBC viatical portfolio. This section performs the following functions:

- **Premiums.** Premiums must be paid on all policies in a timely fashion to insure the insurance policies remain in full force and effect. This includes logging receipt of premium notices, tracking due dates and issuing check requests on all direct pay insurance premiums. Due diligence is performed to verify premium amounts are owed and alternative payment methods are researched such as using cash value.

After payment is made, confirmations of payment are verified through direct carrier contact and banking reconciliation.

- **Policy Cost Maintenance.** All annual reports are extensively reviewed for cost efficiency. This includes in-depth valuation of cost of insurance comparisons to existing accumulation accounts, surrender values, review of dividend options on participating policies, updating policy illustrations as needed and performing associated calculations, and performance of cash value comparisons. These are all calculated and maintained in the VSI database for premium payment monitoring.
- **Conversions.** Process life conversions from term policies and/or Riders that expire on their designated dates and on those with increasing premiums for cost efficiency. These term policies must be tracked and monitored for conversion purposes to avoid the loss of a policy.
- **Waivers of Premium.** Like group policies, there are many individual policies on activated waiver of premium coverage. These waivers also must be annually recertified, or a premium would become due.

The Individual Section works in conjunction with MBC, which oversees all financial obligations of both MBC and VSI, and performs its own due diligence. VSI currently has a post-receiver, reduced staff of 4 employees who handle these responsibilities.

(ii). **Viator Tracking.**

The Tracking Section's principal function is to effectively keep track of the insureds/viators. This section has 5 employees who monitor the whereabouts and health status of approximately 5,500 individual viators. The list of viators is called the "case list." The case list is divided alphabetically into 4 separate lists, which are assigned to the 4 staff caseworkers and one supervisor, who perform the following:

- **Viator Contact.** On a set schedule, every three months, each case worker attempts to make contact with the insureds in one of three ways: (1) by phoning the insured and/or the designated third-party (relative, spouse, friend), (2) mailing a post-card with a return questionnaire, or (3) via e-mail. If an insured is not reached or is otherwise not

responding, a more complex investigation is instituted. VSI uses proprietary investigative tools, in addition to other Internet search engines such as law enforcement/inmate locators, bankruptcy filings, criminal filings, property records, and recorded judgments.

The experienced supervisor of this section also takes primary responsibility for attempting to locate the insureds that the caseworkers are not able to reach. In addition, the Receiver has hired a professional investigator who works several hours each week to assist VSI with hard-to-locate insureds. This investigator uses methods that include contacting foreign embassies, Interpol, and other foreign agencies. This investigator has located several insureds who had left the country and who were located, either deceased or alive, in Australia, Mexico and Africa.

- **Database.** The VSI database is updated with the insured's current information -- address and general health status relayed by the contact. This updated information also appears on the MBC and VSI combined database, which generates the status summary sheet to investors' inquiries. In the status summary sheet, the investors are provided with the last contact made by VSI with the insured.

- **Deaths.** When an insured is not responding, caseworkers must determine whether the insured has passed away. This also requires investigation including Internet death search and/or social security death benefit filings, obituary searches, as well as other proprietary methods. Once a death is confirmed, the caseworkers communicate with the appropriate vital statistics office and obtain the certified death certificate. The death certificate is then provided to the VSI death benefit processing section.

(iii). **Death Benefit Processing.**

The Death Benefits Processing Section consists of 2 employees who process the death benefit claims on behalf of the Receiver and in accordance with this Court's orders. This section also monitors insurance interpleader actions and maintains a death benefit status log. Once a claim is submitted with proof of death, an explanation letter is simultaneously mailed to all investors listed in the MBC records on the particular policy. This includes all beneficiaries listed on the MBC internal records, and not simply the recorded beneficiary, such as a nominally named beneficiary (e.g., UPBNA or American Express Tax & Business Services). This often requires sending hundreds of letters for one matured policy. An investor inquiry phone number is also provided to these investors. When death benefits are received from insurers, they are forward to the Receiver's Operational Representative at MBC for compliance with the Court's order.

(iv). **Investor Relations.**

VSI has two full-time employees and one part-time employee who handle telephone investor inquiries in both Spanish and English. This includes not only the investors who inquire about the death benefit letters, but all other investor calls to VSI. Since mid-March 2005, approximately 1,600 phone calls have been received and returned. These employees also call the investors who provide telephone numbers in their correspondence. This section also maintains a telephone status log for troubleshooting and production monitoring purposes.

C. **Summary of Ongoing Operations.**

The operations of both MBC and VSI have been greatly streamlined and made more cost effective since their move to the same location. The premium payment section of VSI

shares database information with regard to check issuance and payment clearance with MBC, thereby reducing expended time and personnel. Being in one location also permits better coordination of policy maintenance and investor relations. MBC and VSI have also reduced costs by sharing IT support and other support staff with regard to office services (copying and mailing of the hundreds of daily letters) and filing and document control. In addition to reduced time and personnel, the most important reduction of costs since the move has been shared rent, insurance (commercial premises, general liability, flood and content insurance), and security. The new location is also equipped with an on-site warehouse which contains all MBC and VSI documents from the pre-receivership operations. These documents have been organized for document production and operational use.

Finally, the Receiver's Operational Representatives for MBC and VSI are responsible for the human resources for each receivership entity (including payroll and employee supervision) and all business operations such as insurance, vendors, business security, and basic operation control for asset protection -- all of which are performed under the direction and supervision of the Receiver.

CONCLUSION

The Receiver has sought through this Report to explain in greater detail the critical work that MBC's and VSI's core workforce continues to carry out. This work is essential to preserve the Receivership Estate's assets, is for the benefit of the investors and creditors, and cannot effectively continue without the assistance of outside professionals. The Receiver has thus brought to the Court's attention the critical shortage of operating funds available to administer the receivership, to pay these professionals for the substantial work they have performed, or to pay them for work asked of them going forward. The Receiver has also

sought through this Report to explain in greater detail why bankruptcy is not a practicable solution for this dilemma: it will neither alleviate the critical shortage of funds nor provide a workable forum for fair resolution of this case for MBC's investors and creditors. Accordingly, the Receiver respectfully submits immediate relief is needed and requests that the Court approve the Receiver's Motion to Clarify and the Receiver's Disposition Motion.

DATED: August 17, 2005.

Respectfully submitted,



ROBERTO MARTINEZ
RECEIVER

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing was served by electronic mail to the parties on the attached Receiver's Service List on August 17, 2005.

A handwritten signature in black ink, appearing to read 'C. Miner', written over a horizontal line.

Curtis Miner