

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

CASE NO. 04-60573-CIV-MORENO

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

MUTUAL BENEFITS CORP., *et al.*,

Defendants,

VIATICAL BENEFACTORS, LLC, *et al.*,

Relief Defendants.

**RECEIVER'S REPORT TO INVESTORS ABOUT THE
ADMINISTRATIVE FEES THEY ARE BEING CHARGED**

The Receiver for Mutual Benefits Corp. ("MBC"), Viatical Services, Inc. ("VSI"), Viatical Benefactors, LLC and Anthony Livoti, Jr., P.A. as Trustee is writing this Report for all MBC investors to answer a number of questions and complaints that have been raised about the administrative fees that are being charged to investors. The fee for the calendar year 2008 was \$240 per investment interest. A number of investors have called or e-mailed or written to the Court, to the Receiver or to VSI to ask a number of questions and to complaint about the administrative fees: Why are they being charged? Why are they so high? What is being done with the money? These are all good and timely questions. The goal of this Report is to give the investors a detailed, though hopefully not unnecessarily complicated, answer to these questions.

1. Why Is The Receiver Charging An Administrative Fee At All?

Many investors have asked: Why is the Receiver charging the investors any sort of administrative fee at all? After all, the investors have been the victims of a fraud by MBC's former owners, now have to pay additional money to pay their shares of the premiums to keep the policies in force, and they are being charged an administrative fee on top of that. Not surprisingly, this has many investors very upset.

The best thing for the investors, of course, would be if the Receiver did not have to charge any administrative fee. Unfortunately, this is just not possible. In the Disposition Process ordered by the Court in this case, the investors were given the option to choose to keep their policies and assume responsibility for the premiums, pay an administrative fee for the servicing of the policies, and take on all of the risks this would entail going forward. As a result, VSI is currently (as of May 31, 2008) responsible for administering 2,786 insurance policies that are "Keep Policies." Those insurance policies have a total of 13,709 different investors from all over the world who have investment interests in the policies (the "Keep Investors"). Those investors hold a total of 20,519 fractional investment interests in the Keep Policies. The total face value of these Keep Policies is approximately \$929 million. This is a huge asset, a huge portfolio of policies, and a huge responsibility for VSI.

The single most important responsibility for VSI is to protect that \$929 million in assets for the investors. If a policy were to lapse due to VSI's failure to collect the premium payment due, the investment of all of the investors on that policy could be lost. Or, if a policy were to lapse due to VSI's failure to submit a collected premium to the insurance company on time, the investment of all of the investors on that policy could be lost. Or, if VSI were to lose contact with an insured or failed to learn of a policy's "maturity" resulting from the death of an insured,

the payment of death benefits to all investors on that policy would be at risk. Fortunately, none of these things has happened to date.

This has not been an easy task. The Receiver and VSI have taken as much care as is practicable to make sure that the people and procedures are in place to carry out all of the different tasks that are necessary to keep this system running relatively smoothly. Below, we have given a description of what exactly VSI does on a day-to-day basis to give investors a better idea of what this entails. To put things in perspective, VSI existed long before the Receivership to service the policies that were viaticated by MBC. The need for VSI has not changed since the Receivership. In fact, VSI's responsibilities have greatly increased since before the Receivership. For example, MBC used to take care of all "customer service" issues. Since MBC has been shut down and its viatical settlement business discontinued, that responsibility has been shifted to VSI. Also, MBC used to handle the distribution of death benefit checks to investors. That responsibility has also now gone to VSI. But most importantly, the servicing of 2,786 Keep Policies for 13,709 Keep Investors has imposed the largest new responsibility on VSI by far. MBC and VSI never before had a system in place to bill investors for their share of the premiums, because they had never before done it. The entire infrastructure for doing this, from software and database to personnel and procedures, had to be created by VSI largely from scratch.

All of this has to be paid for somehow. VSI does not have any money of its own. At the beginning of the Receivership in May 2004, VSI had approximately \$3.7 million in cash in the bank. It had no other significant assets. It has been four years since then though, and that money has been spent to keep VSI running.

The Receiver does have other non-VSI money. For example, the Receiver has collected substantial amounts from the sale of policies for investors who chose to sell their policies in the Disposition Process. In theory, that money could be used to pay or defray the administrative fees for Keep Investors, but that would not be fair to the Sell Investors. In effect, money that should go to Sell Investors in the claims process would be taken for the benefit of Keep Investors. Also, the Receiver has collected substantial amounts as a result of lawsuits brought against the former owners of MBC and others who were responsible for the investors' losses. This money will be distributed to investors as part of the claims process that is going on now. In theory, that money could also be used to pay for the administrative costs of VSI, but again that would not be fair to other investors who are part of the Receivership.

In short, the only practical source of revenue for VSI is to charge some sort of administrative fee to the investors who have chosen to keep their policies.

2. How Did the Receiver Come Up With the Amount of the Administrative Fee?

The Receiver came up with the amount of the administrative fee by first trying to figure out how much it would take to operate VSI on an annual basis in light of its new responsibilities. This is roughly the amount that would have to be collected on an annual basis. This was not a simple task. It was difficult to predict the cost of the personnel and infrastructure that would be needed to implement a system for servicing the Keep Policies. Since VSI had never done this in the past, its annual budgets in the past were of limited use for projections.

In addition, it is important to be sure that the administrative fee is high enough that VSI will be able to service all of the Keep Policies and all of the Keep Investors for the entire year. It is very difficult to predict with any precision how many investors will agree to pay their administrative fees and continue with their investment and how many will decide they do not

want to any longer. Some investors understandably decide that they do not have the money or do not want to take the risk of continuing to pay their share of the premiums and the administrative fee any longer. And, some investors (fortuitously) have their policies mature, so they end up dropping out of the pool of investors paying administrative fees. As a result, it is very difficult to predict how much will actually be collected by charging an administrative fee to investors.

The Receiver's accountants did their best to predict this by looking at the trends in the past, but there is not much of a past to look at it, so the investor "attrition rate" is very much a guesstimate. Also, the Receiver has to "err on the high side." If the administrative fee is set too low, and VSI collects too little to fund its operations for the year, it is simply not practicable for VSI to then go back to the investors and ask for more. It would take too long and be too unpredictable as to who would actually pay an additional fee if asked. Plus, the potential consequences of VSI running out of money to continue servicing the policies are very severe.

As will be discussed in the next section, VSI's projected annual budget for 2008 is approximately \$3.65 million. That is also the approximate amount that it cost to operate VSI in 2007. Accordingly, the Receiver had to make sure that the amount collected in administrative fees is higher than that amount to ensure VSI's continued operation.

3. Why Does It Cost So Much to Keep VSI Running?

If VSI's projected annual budget is approximately \$3.65 million, the next logical question is: Why does it cost so much to keep VSI running? Here is a chart that outlines what that money is being spent on:

VIATICAL SERVICES INC.		
ANNUAL OPERATING EXPENSE BUDGET		
Copy, Postage and Printing	\$95,200	2.61%
Equipment Purchases and Rental	52,000	1.43%
Information Technology	250,000	6.86%
Insurance	154,800	4.25%
Office Expense and Supplies	46,900	1.29%
Payroll	1,901,400	52.16%
Payroll Taxes	160,922	4.41%
Professional Fees (Legal, Accounting, Technology)	600,000	16.46%
Medical and Death Records	16,600	0.46%
Rent	156,600	4.30%
Repairs and Maintenance	34,500	0.95%
Security	72,000	1.97%
Utilities	54,700	1.50%
Other / Contingency	50,000	1.37%
Total Operating Expenses	\$3,645,622	100.00%

The biggest part of this budget is payroll. VSI currently employs 31 people in the following areas (and MBC employees 2 people who spend an increasing amount of their time on VSI-related work):

▪ Management	2
▪ Insured Tracking Department	3
▪ Policy Premium Department	5
▪ Policy Changes Department	4
▪ Customer Service	4
▪ Accounting	7
▪ Claims Processing Department	2
▪ Offices Services	3
▪ IT	1
Total Employees	31

What do these people do on a day-to-day basis to help the investors and to protect their investments? As an initial matter, it is worth remembering that the VSI employees are working under very difficult circumstances: they are supervised by a Receiver whose job it is to keep their budget tight and their operations “barebones”, and they are working to service investments held

by investors who (justifiably) are very upset and angry about the predicaments they have found themselves in. This is not an easy job for anyone. That said, here is a brief description of some of the key functions performed by VSI:

a. Policy Premium Collection and Payment.

This Policy Premium Department is a department that never previously existed at VSI and had to be created following the Disposition Process in order to service the Keep Investors. This Department (along with the Accounting Department) is responsible for determining and managing the amounts that have to be paid to insurance companies as premiums to keep the 2,786 Keep Policies in force. This takes up more VSI resources than any other function.

On the “collection side” of this process, VSI employees are responsible for: (1) ordering policy illustrations and premium schedules from insurance carriers for universal life and term policies, (2) auditing policies for billing purposes (including the analysis and determination of annual premiums based on policy illustrations, premium schedules and annual reports), (3) auditing “Case Files” following the reallocation of investor interests due to non-payment of premium invoices in order to verify and confirm that investors are correctly invoiced during the next billing cycle, (4) processing investor premium and administrative fee “Invoices,” (5) processing investor “Reminder Notices” to encourage maximum investor response, (6) processing “Forfeiture Notices” to investors who do not pay their premium and administrative fee payments, (7) auditing undersubscribed policies for auction, and (8) responding to numerous Customer Services inquiries regarding investor premium invoices.

Employees in the Accounting Department also participate in this process by: (1) posting to the VSI Premium Billing & Tracking System all payments received from investors, (2) processing bank deposits, (3) reconciling bank statements with VSI’s Premium Billing &

Tracking System, (4) creating and distributing new invoices for investor reinstatements (including calculating new percentages and corresponding amounts due), and (5) processing “shortfall” premium payments to determine refund amounts.

There are approximately 20,519 fractional investment interests in the Keep Policies. As a result, the amount of paperwork (initial premium invoices, reminders, shortfall notices, forfeiture notices) involved in this process is daunting. And, the corresponding task of tracking and recording the results of that paperwork that are necessary just to bill the investors for their correct share of the premiums, keep track of who has paid their share and who has not, and make the corresponding adjustments to investor’s investment interests are likewise daunting.

On the “payment side” of this process, VSI employees are responsible for: (1) preparing check requests for the payment of premiums to insurance carriers, (2) posting checks to the Policy Billing & Tracking System, (3) mailing the checks to the insurance carriers, and (4) confirming with the insurance carriers that checks have been received and credited.

Approximately \$36 million in annual premium payments are being coordinated and overseen by VSI to insurers.

Because the disposition of the Keep Policies naturally results in a certain number of investors declining to continue with their investment, VSI also has a host of responsibilities to try to protect investors’ interests when this happens. To this end, VSI personnel are responsible for: (1) analyzing “undersubscribed” policies for possible reduction of face value or other measures that can be taken to preserve the policy, and (2) auditing and evaluating undersubscribed policies for possible auction of the “unsubscribed interests.”

b. Insured Tracking Department.

As it did before the Receivership, VSI is responsible for tracking the insureds to determine whether they are still alive or whether their policy has “matured.” The insureds on the 2,786 Keep Policies are tracked by VSI employees on a quarterly basis. VSI uses a variety of means to do this, including sending quarterly postcards (to “HIV/AIDS insureds”), sending quarterly letters (to “life settlement insureds”), quarterly e-mails, making telephone calls to non-responders, searching certain internet sites for non-responders, contacting references such as family members and friends for non-responders, and conducting obituary searches. VSI also coordinates with private investigators to locate insureds who cannot otherwise be reached, and has been able to track down insureds who have “disappeared” around the United States and elsewhere in the world. For insureds who have died, VSI employees will obtain death certificates through the appropriate governmental authority or family member to commence the death benefit claim process.

c. Death Benefit Claim Processing and Distribution.

Employees in VSI’s Claims Processing Department are responsible for the reporting of deaths to insurance carriers and requesting the appropriate claim paperwork. All of the investors on the “matured” policy have to be notified and sent appropriate tax forms required for distribution of their shares of the death benefits (IRS Form W-9 or W-8BEN). VSI employees complete the claim forms and submit them to the insurance carriers and follow up with the insurers and provide any additional documentation to support payment of the claim. Insurers frequently raise questions about the scope of the Receivership, the authority of the Receiver to submit death benefit claims, and other issues. This can require repeated follow-ups from VSI employees, the involvement of VSI’s in-house legal representative, or the involvement of outside

counsel to write demand letters or otherwise attempt to resolve disputes with insurers.

Once death benefit checks are received from the insurers, employees in VSI's Accounting Department are responsible for the processing of death benefit checks. This includes verification of who the investors are on the policy and the amount of their investment interest, completing any outstanding investor changes, checking for attorney representation, reviewing tax withholding issues, and reconciling the death benefit payment with any administrative fee or premiums still owed by the investor. The Accounting Department is also responsible for: (1) calculating the distribution of death benefits (including determining accrued interest, premium refunds or reimbursements, administrative fees to be withheld and tax withholdings), (2) printing, posting, obtaining signatures, and mailing death benefit checks to investors, and (3) preparing tax reporting forms to the IRS for death benefit disbursements made.

During the course of the Receivership, the Receiver has received approximately \$185 million in death benefit proceeds on approximately 600 matured policies through April 30, 2008. VSI has distributed approximately \$166 million of these proceeds to investors (with the remainder in the process of distribution).

d. Customer Service Department

The Customer Service Department has also had to be created since the Receivership. Prior to the Receivership, MBC handled all customer service-type inquiries and complaints from investors. As a general matter, the employees in the Customer Service Department are the ones initially responsible for answering all investor calls, e-mails and letters on any topic. Most recently, these employees have been spending most of their time responding to questions regarding the Claims Process. When an investor who has received a Claim Form calls the 1-800 number provided on the Claim Form, the Customer Service Department is available (1) to

answer questions about the claims process, (2) to verify that a Claim Form has been sent out to the investor, (3) to verify the address the Claim Form was sent to, (4) to accept change of address requests, (5) to arrange for the re-sending of Claim Forms where requested, (6) to verify the investor's Claim Form has been received, and (7) to respond to the wide variety of other frequently asked questions from investors who have received claim forms.

Separate from the Claims Process, the Customer Service Department initially handles all questions regarding billings received by investors when they receive their invoices to pay their share of the premiums and the administrative fee. This includes coordinating with the billing and accounting areas in order to respond to specific questions about the amount of the bills. The Customer Service Department also receives numerous calls about the status of death claims on policies that have matured. The Customer Service employees gather information from the Claims Processing Department to ascertain if W-9 and W-8BEN forms have been received from investors, if "maturity letters" have been sent out to investors, the status of death benefit claims (paid or not paid), and information on when death benefits are expected to be paid.

The volume of calls and questions fluctuates depending on what is going on generally in the Receivership at any given time. For example, with the claims process currently underway, the Customer Service Department currently receives approximately 300 phone calls, 100 e-mails and 10 letters per day.

e. Policy Changes Department.

The VSI employees in the Policy Change Department are responsible for processing the numerous policy change requests that VSI receives. This includes: (1) processing investor address changes, (2) processing insured beneficiary and ownership changes (including ownership changes to the Receiver for the Keep Policies), (3) updating the VSI databases for policy

conversion changes, (4) updating the VSI databases for increases/decreases in death benefits, and (5) making changes to policy interests to reflect investor changes due to IRA distributions, investor deaths, divorces, dissolutions of trusts, etc. The volume of calls and questions fluctuates. For example, separate and apart from the various contacts the Customer Service Department receives, VSI is also receiving roughly 75 mail-in requests, 15 e-mail requests and 20 phone calls daily relating to various policy change requests.

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Finally, a significant part of VSI's annual budget is spent on outside professional fees (16.46%). VSI relies primarily on the following outside professionals:

- Accountants (Berkowitz Dick Pollack & Brant): to handle the financial, tax and accounting issues that go with requiring the expertise of outside professionals, and to prepare tax returns and other forms required by the Internal Revenue Service.
- Lawyers (Colson Hicks Eidson and Kozyak Tropin & Throckmorton): to assist VSI with legal issues, ranging from dealing with insurance companies and investors' attorneys, to dealing with state regulators, to negotiating and obtaining Court approvals for various procedures used by VSI (such as carrying out fractional interest auctions).
- Tax counsel (Bilzin Sumberg Price & Baena): to provide tax advice in the preparation of tax returns and other forms required by the Internal Revenue Services.

VSI's most significant outside, professional expense has been for the design, development, testing, implementation and documentation of its Premium Billing & Tracking System. This was done by information technology professionals with the Berkowitz Dick Pollack & Brant accounting firm. This System had to be created for VSI essentially from scratch to enable it to allocate the billing of administrative fees and policy premiums to investors, track the collection of these fees and premiums, and reallocate fees and premiums among investors as required as investors fail to remit the amounts billed to them. This is a highly complex

information system. It took a substantial amount of time, and cost a substantial amount of money, to create. However, it is also absolutely essential to VSI's ability to service the Keep Policies, so VSI had no choice but to undertake this expense.

Could these costs be reduced? The answer is yes. The creation of the Premium Billing & Tracking System from scratch took a substantial amount of time and cost a substantial amount of money. However, it was a "onetime" cost. Now that the System is up and running, the cost of maintaining the System from an information technology standpoint will be much less. Also, the Receiver has made an effort to have as many functions as possible performed "in house" by VSI, so as not to incur additional outside professional expenses. For example, VSI attempts to answer and resolve all investor questions and disputes before involving the Receiver's counsel so as to minimize the amount of outside "attorney time" spent. In addition MBC employs an in-house legal representative to handle as many issues raised by investors' lawyers, regulators, and insurance companies as possible, again to reduce the amount of "outside attorney time" spent.

4. Why Did the Receiver Choose to Charge an Administrative Fee "Per Investment Interest"?

If the Receiver has to charge an administrative fee to investors, and the fee has to be enough to keep VSI running on an annual basis, the next logical question is: What is the fairest and most efficient way to charge the administrative fee?

The Receiver chose to use a system where the administrative fee was charged **per investment interest**. In other words, an investor with only one investment interest pays the administrative one time per year, but an investor with multiple investment interests will have to pay for each interest. As will be discussed below, this is not the only system that could be used. But, on balance, it seemed to be the fairest system for the greatest number of investors.

The Receiver calculated the administrative fee to charge for each investment interest as

follows. With an expense budget of approximately \$3.65 million per year for VSI (as discussed above), and 20,519 investment interests, this comes out to an average fee per investment interest of approximately \$178. However, this figure assumes that every single investor sends in their administrative fee on every single investment interest. That, of course, is not a realistic or safe assumption. It also would assume that no policy matures before the investors on the policy send in their administrative fees with the result of the investors on that policy dropping out of the investor pool. That too, of course, is not a realistic or safe assumption. So, the Receiver assumed that roughly 20% of the investors would either not send in their administrative fee or have their policy mature. This assumption increases the fee to approximately \$222 per investment interest. Finally, given the risk and potentially extremely bad consequences of collecting too little in administrative fees, a safety cushion was added to the fee of approximately 9%. The administrative fee was thus set for this year at \$240 per investor interest.

The Receiver decided that a “per investment interest” fee would be the fairest method for charging an administrative fee for several reasons. First and foremost, of the various approaches considered, this approach results in the lowest administrative fee per investor for the greatest number of investors. The great majority of investors (72.1%) have only one investment interest. Only a small fraction of the investors (1.1%) have more than 5 investment interests. Here is a chart that shows the break-down for all of the Keep Investors:

# of Policy Interests Held by the Investor	Number of Investors	%
1	9,882	72.1%
2-5	3,675	26.8%
6-10	132	1.0%
>10	20	0.1%
	13,709	100.0%

Second, charging the fees this way corresponds most closely with the practical reality that the amount of work required by VSI is roughly equivalent to the number of investment interests.

Third, this is the cheapest way to do it from a VSI budget perspective too. It is less expensive for VSI to charge the administrative fee “per investment interest” since this is the same way that premiums are charged. This leads to lower overall costs to be borne by investors.

One consequence of this approach is that the “fees” on any given policy can appear to be unreasonably large. For example, investor Ronald Meyers has pointed out for the Court an example of a policy with 308 investors on it that would in theory be generating an administrative fee of \$73,920. Mr. Meyer is absolutely right that this would be an outrageous amount for the servicing of a single policy. However, this does not take into account the full picture. The fees are not supposed to represent the cost of servicing a particular policy. They are an effort to spread the cost of servicing all of the policies out as fairly and evenly as possible among all of the investors.

Mr. Meyers is one of the very small number of investors who have over ten investment interests. (Only 0.1% of the investors are in that situation; and only 1% own 6-10 policy interests.) Some of these investors are institutional investors, but Mr. Meyers appears to be an individual investor, so it is understandable that the burden of paying multiple administrative fees in light of his multiple investment interests can fall heavily upon him. In order to try to address this situation, in the next billing cycle, VSI will come up with a method for discounting or capping the administrative fee for investors like Mr. Meyers who have a large number of investment interests.

The Receiver thought about three other alternatives for collecting administrative fees. Each one has its disadvantages though.

One option was to charge a **fixed fee per policy**. Under this approach, a fixed fee would be charged per policy regardless of how many investors are on the policy. VSI has a budget of approximately \$3.65 million per year, with 2,786 policies to service, so the fee would need to be at least \$1,310 per policy. If you assume a 20% rate of attrition of investors contributing, the fee would need to be at least \$1,640 per policy. And, if you “err on the high side,” you would probably need to charge roughly \$1,800 per policy. If the policy has 100 investors on it (as some do), the fee per investor would only be a very low \$18. But, if the policy has only 1 investor on it (as the great majority do), the fee for that investor would be the full \$1,800! The potential for unfairness is clear. As the following chart shows, although there are a relatively small number of policies that are owned by a large number of investors, the vast number of policies are owned by five investors or less:

# of Investors on the Policy	Number of Policies	%
1-5	2,088	74.9%
6-10	371	13.3%
11-25	189	6.8%
26-50	70	2.5%
51-100	47	1.7%
>100	21	0.8%
	2,786	100.0%

Also, the more investors there are on a policy, the more expensive it is to service the policy. It takes more time and effort to collect premium payments from more investors, to respond to questions from more investors, etc. So, it did not seem fair to charge the same fee for multiple-investor policies as for single-investor policies. Finally, most of the time, investors were placed on a policy by happenstance. An investor would typically have no idea whether he

or she was being placed on a policy as the only investor or being placed on a policy with multiple investors. So, it seemed unfair to “penalize” the investor that finds himself or herself on a policy with few or no other investors, while “rewarding” the investor who fortuitously finds himself or herself on a policy with many other investors.

A second option was to charge a **fixed fee per investor**. Under this option, there would be a fixed administrative fee for each investor, regardless of the policy(s) that they are on and regardless of the number of investments held by that investor. With a budget of approximately \$3.65 million per year and 13,809 Keep Investors, this would result in an administrative fee per investor of approximately \$265. Again, if you assume a 20% rate of attrition of investors contributing, the fee would need to be at least \$330 per investor. And, if you “erred on the high side,” you would probably need to charge roughly \$350 per investor.

The Receiver decided that charging fixed administrative fees per investor would lead to unfair results. Most importantly, this approach ends up with a higher average fee per investor. Also, it typically takes more time and expense to service an investor who has multiple investments. So, it would seem unfair that they should pay the same fee as an investor who only has one investment. The choice to make multiple investments (or just a single investment) typically was a conscious decision by investors (unlike the determination of what policy their investment ended up on). Finally, the number of investors who own multiple policy interests is not that easy to determine. A single investor may own multiple policy interests under different names, such as under their individual name, a spouse’s name, a retirement account name. Some investors would undoubtedly end up getting billed more than once for the administrative fee even though they really only a single investor.

A third option was to charge a **fee based on percentage of face value**. Under this option, the fee would be charged to investors pro-rata, based upon a percentage of the death benefit owned or the amount invested. In other words, an investor with a \$1,000,000 investment would be charged a higher fee than an investor with a \$10,000 investment. The Receiver rejected this option for a number of reasons. The cost to administer a policy or an investor's interest in a policy does not really depend on the size of the death benefit or the amount of the investment. This approach would also result in different investors on the same policy paying different amounts in fees. Finally, it would be a lot more complicated and expensive to put this approach in place as opposed to the other options. The amount of an investor's investment in a policy may easily change over time because of the way the Keep Policies are being handled. As investors drop off a policy, and other investors pick up their share of the premiums, the size of an investor's investment may increase. This would mean their administrative fee would go up.

In sum, charging an administrative fee calculated per investment interest seemed the fairest and least expensive of the various options that could be chosen.

5. How Much Has the Receiver Collected in Administrative Fees So Far and What Has He Done With Them?

In the first billing cycle, which lasted for the year extending from July 1, 2006 (the date the Disposition Process concluded) through June 30, 2007, VSI collected a total of approximately \$5,347,000 in administrative fees.¹

Billing Cycle # 1

	<u>Quantity</u>	<u>\$ Amount</u>
Investor Payments	23,550	\$5,267,000
Death Benefit		
Deductions	350	\$80,000
Total	<u>23,900</u>	<u>\$5,347,000</u>

¹ In that initial billing cycle, each investor was charged an annual per investor fee of \$170, along with their pro rata portion of an annual per policy fee of \$195. As a result, an investor who owned a single policy in its entirety would have paid \$365.

The amount collected ended up being more than the Receiver and VSI had projected would be collected, since more investors paid their administrative fees than had been expected. As a result, VSI did not need to charge any administrative fee for the 6-month period lasting from July 1, 2007 through December 31, 2007. The investors thus benefited from a 6-month “fee moratorium” during that period of time while VSI continued to operate using the excess amount collected in the first billing cycle.

VSI did not charge an administrative fee again until 2008. This also allowed VSI to “catch up” its billing cycles to the calendar year. For the 2008 billing cycle, VSI has charged a single administrative fee of \$240 per investment interest (which has ended up being a lower fee for most investors from the first billing cycle). VSI has collected approximately \$3.6 million to date and projects it will collect approximately \$3.9 million by the time the billing cycle is over.

<u>Billing Cycle #2</u>	<u>Quantity</u>	<u>\$ Amount</u>
Investor Payments (thru 6/9/08)	14,220	\$3,413,000
Death Benefit Deductions	812	195,000
Est. Remaining Payments (1,564 inv x .80)	1,251	300,000
Total	16,283	\$3,908,000

The amount that is likely to be collected in 2008 is thus pretty much in line with the amount of VSI’s operating budget for 2008. VSI currently has available operating funds of approximately \$3.5 million in the bank.

6. Could/Should the Court Order a Reduction in the Amount of the Administrative Fee Charged to Investors?

The Court certainly could order a reduction in the amount of the administrative fee that is being charged on a per investment interest basis. The Court could also direct the Receiver to implement one of the other options for collecting administrative fees discussed above. But, the

Receiver respectfully suggests, the safest and most conservative approach is not to reduce the administrative fees at this time.

As noted above, VSI currently has available operating funds of approximately \$3.5 million in the bank. If VSI stays within its operating budget as expected, it will likely use a little more than \$1.8 million to fund its operations for the second half of 2008. That should leave approximately \$1.7 million in operating funds at the end of the year. However, there has to be some “cushion” in the budget; it would not be safe to plan a budget where VSI would be left with close to \$0 in the bank at the end of the year. Although VSI will begin sending bills for administrative fees for 2009 before the end of 2008, there will be some time lag before these administrative fees are collected, and there will always be some uncertainty as to how much will actually be collected.

Also, when planning the administrative fee for calendar year 2009, VSI and the Receiver can take into account what amount is left over for operations from the previous year’s fees. Unfortunately, this does not likely mean that administrative fees can be reduced. Each year, the number of investors paying administrative fees will reduce, because some investors will “drop out” of their investments and some will have their policies mature. This will also mean a decrease in the amount of work that has to be performed by VSI, but there is not a linear correlation between a decrease in the number of policies being serviced and a decrease in VSI’s expenses. So, going forward, a smaller pool of Keep Investors will have to bear the administrative costs.

It is important for investors to remember that VSI is currently not a profit-making enterprise; it is part of the Receivership. The funds for operations will not be a “profit” for anyone involved. It can and will only be used for the benefit of the investors. One way it can be

used is to help offset the amount of administrative fees going forward – though this is not likely to result in a decrease in administrative fees. Also, when VSI is released from this Receivership, any funds available to VSI can be used to establish some sort of trust account or restricted account to defray the administrative costs for Keep Investors in the future – an issue discussed in the next section.

7. **What Will Happen With the Administrative Fees When the Receivership Is Over?**

Finally, all of these questions point out an important issue that will be faced by the Receiver, the Court and the Keep Investors when this Receivership is brought to an end. The Receivership, of course, cannot continue forever. In fact, the claims process is currently well underway. Once the claims process is concluded, the Receiver will submit a plan for the distribution of all of the assets of the Receivership (such as the proceeds of the sales of the Sell Policies and the funds that have been recovered in a number of different lawsuits against parties responsible for the investors' losses). Once that distribution is made, the Receivership will likely conclude.

At some point, the Receivership will also need to “spin off” VSI. VSI will need to continue to exist after the Receivership in order to service some number of Keep Policies which will undoubtedly be active policies for many, many years to come. The Receiver has received the Court's permission, and has begun the process, to identify and negotiate with potential buyers of VSI. Any consideration that the Receiver receives for the sale of VSI will be for the benefit of investors. However, any buyer of VSI will have to make it operate on some source of revenue, such as administrative fees. And once VSI is out of the Receivership, there will be less (or possibly no) control over the fees that are charged to investors to service their Keep Policies. One of the Receiver's primary concerns in finding a buyer for VSI will be to (a) identify a buyer

that can best control administrative fees for the Keep Investors, and (b) come up with a means to either control, limit or defray the administrative fees charged to the Keep Investors after the Receivership.

Respectfully submitted,

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