AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

# RETIREMENT PROTECTION: FIGHTING FRAUD IN THE SALE OF DEATH

## HEARING

BEFORE THE

SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

FEBRUARY 26, 2002

Printed for the use of the Committee on Financial Services

**Serial No. 107–55**

U.S. GOVERNMENT PRINTING OFFICE

78–132 PDF WASHINGTON : 2002

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

## HOUSE COMMITTEE ON FINANCIAL SERVICES

MICHAEL G. OXLEY, Ohio, *Chairman*

JAMES A. LEACH, Iowa
MARGE ROUKEMA, New Jersey, *Vice Chair*
DOUG BEREUTER, Nebraska
RICHARD H. BAKER, Louisiana
SPENCER BACHUS, Alabama
MICHAEL N. CASTLE, Delaware
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
ROBERT W. NEY, Texas
BOB BARR, Georgia
SUE W. KELLY, New York
RON PAUL, Texas
PAUL E. GILLMOR, Ohio
CHRISTOPHER COX, California
DAVE WELDON, Florida
JIM RYUN, Kansas
BOB RILEY, Alabama
STEVEN C. LATOURETTE, Ohio
DONALD A. MANZULLO, Illinois
WALTER B. JONES, North Carolina
DOUG OSE, California
JUDY BIGGERT, Illinois
MARK GREEN, Wisconsin
PATRICK J. TOOMEY, Pennsylvania
CHRISTOPHER SHAYS, Connecticut
JOHN B. SHADEGG, Arizona
VITO FOSSELLA, New York
GARY G. MILLER, California
ERIC CANTOR, Virginia
FELIX J. GRUCCI, JR., New York
MELISSA A. HART, Pennsylvania
SHELLEY MOORE CAPITO, West Virginia
MIKE FERGUSON, New Jersey
MIKE ROGERS, Michigan
PATRICK J. TIBERI, Ohio

JOHN J. LAFALCE, New York
BARNEY FRANK, Massachusetts
PAUL E. KANJORSKI, Pennsylvania
MAXINE WATERS, California
CAROLYN B. MALONEY, New York
LUIS V. GUTIERREZ, Illinois
NYDIA M. VELÁZQUEZ, New York
MELVIN L. WATT, North Carolina
GARY L. ACKERMAN, New York
KEN BENTSEN, Texas
JAMES H. MALONEY, Connecticut
DARLENE HOOLEY, Oregon
JULIA CARSON, Indiana
BRAD SHERMAN, California
MAX SANDLIN, Texas
GREGORY W. MEEKS, New York
BARBARA LEE, California
FRANK MASCARA, Pennsylvania
JAY INSLEE, Washington
JANICE D. SCHAKOWSKY, Illinois
DENNIS MOORE, Kansas
CHARLES A. GONZALEZ, Texas
STEPHANIE TUBBS JONES, Ohio
MICHAEL E. CAPUANO, Massachusetts
HAROLD E. FORD JR., Tennessee
RUBÉN HINOJOSA, Texas
KEN LUCAS, Kentucky
RONNIE SHOWS, Mississippi
JOSEPH CROWLEY, New York
WILLIAM LACY CLAY, Missouri
STEVE ISRAEL, New York
MIKE ROSS, Arizona

BERNARD SANDERS, Vermont

Terry Haines, Chief Counsel and Staff Director

---

## SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

SUE W. KELLY, New York, *Chair*

RON PAUL, Ohio, *Vice Chairman*
PETER T. KING, New York
ROBERT W. NEY, Texas
CHRISTOPHER COX, California
DAVE WELDON, Florida
WALTER B. JONES, North Carolina
JOHN B. SHADEGG, Arizona
VITO FOSSELLA, New York
ERIC CANTOR, Virginia
PATRICK J. TIBERI, Ohio

LUIS V. GUTIERREZ, Illinois
KEN BENTSEN, Texas
JAY INSLEE, Washington
JANICE D. SCHAKOWSKY, Illinois
DENNIS MOORE, Kansas
MICHAEL CAPUANO, Massachusetts
RONNIE SHOWS, Mississippi
JOSEPH CROWLEY, New York
WILLIAM LACY CLAY, Missouri

# CONTENTS


| | Page |
|---|---|
| Hearing held on: | |
| February 26, 2002 | 1 |
| Appendix: | |
| February 26, 2002 | 25 |

WITNESSES

TUESDAY, FEBRUARY 26, 2002

| | |
|---|---|
| Beriault, Greg, Postal Inspector, Fraud Team Leader, U.S. Postal Inspection Service, Indianapolis, IN | 8 |
| Covington, Hon. J. Lee II, Director, Ohio Department of Insurance | 6 |
| Geyer, Thomas E., Assistant Director, Ohio Department of Commerce | 15 |
| Lazar, John W., class representative in lawsuit against Liberte Capital Corp., Clinton Township, MI | 11 |
| Lewis, David M. Esq., President, Life Settlement Institute | 13 |
| Mercer, Stephen B., Esq., Attorney, Sandler & Mercer, PC, Rockville, MD; publisher "AIDS Practice Manual"; co-author, "Viatical Settlements," 1996 to 2000 | 10 |

APPENDIX

| | |
|---|---|
| Prepared statements: | |
| Kelly, Hon. Sue W. | 26 |
| Oxley, Hon. Michael G. | 28 |
| Gutierrez, Hon. Luis V. | 30 |
| Jones Tubbs, Hon. Stephanie | 32 |
| Rogers, Hon. Mike | 33 |
| Beriault, Greg | 34 |
| Covington, Hon. J. Lee II | 46 |
| Geyer, Thomas E. | 57 |
| Lazar, Wayne | 63 |
| Lewis, David M. | 65 |
| Mercer, Stephen B., Esq. | 71 |

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

| | |
|---|---|
| Kelly, Hon. Sue W.: | |
| State Viatical Laws Chart | 80 |
| Gutierrez, Hon. Luis V.: | |
| Written questions for Lee Covington, David M. Lewis and Steve Mercer | 81 |
| Lazar, Wayne: | |
| Andrew C. Storar Esq. and Gerald R. Kowalski Esq., statements for the record | 96 |
| "Liberte Losses Hit Small City Hard," *Toledo Blade*, February 24, 2002 | 82 |
| List of constituents and amount of money lost | 85 |
| Letters from concerned citizens | 87 |
| Mercer, Stephen B., Esq.: | |
| Aids Advocacy, District of Columbia Bar Association | 99 |
| NAIC's Compendium of State Laws on Insurance Topics | 107 |
| State Securities Administrators' Regulatory Positions on Viatical Investments | 112 |
| Wolk, Gloria Grening, prepared statement | 114 |

# RETIREMENT PROTECTION: FIGHTING FRAUD IN THE SALE OF DEATH

**TUESDAY, FEBRUARY 26, 2002**

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS,
COMMITTEE ON FINANCIAL SERVICES,
*Washington, DC.*

The subcommittee met, pursuant to call, at 2:00 p.m., in room 2220, Cannon House Office Building, Hon. Sue W. Kelly, [chairwoman of the subcommittee], presiding.

Present: Chairwoman Kelly; Representatives Cantor, Ney, Tiberi, Gutierrez, and S. Jones.

Chairwoman KELLY. Good afternoon. This hearing of the Subcommittee on Oversight and Investigations will come to order. I want to thank all Members of Congress who are present today, and there are some coming.

Without objection, all Members present will participate fully in the hearing, and all opening statements and questions will be made part of the official hearing record.

Today, we will examine a sector of the financial services industry that attempts to assist the elderly and terminally ill in meeting their financial obligations. Viatical settlements involve buying life insurance policies from elderly or terminally ill individuals at a discount, then marketing the policies as investments.

In a proper transaction, the policyholder assigns the policy to a viatical settlement company for a percentage of the policy's face value. The settlement company then sells the policy to a third-party investor. The settlement company or the investor becomes the beneficiary to the policy, pays the premiums, and collects the face value of the policy after the original policyholder dies.

This industry began, in large measure, as a noble means for allowing AIDS patients to pay the costs of their steep medical bills before death. Unfortunately, bad actors have taken advantage of a situation to create or buy phony policies and then fraudulently bilk investors who expect a healthy return. When you look at the viatical settlement industry, you see that viaticals start out as insurance policies, but end up as securities sold as investments.

We have reviewed the status of viaticals' regulation by the States and—we have to turn that chart over—we have a chart here that you will see on that stand—and we have found that some States treat viaticals as securities or as insurance, and some States treat it as both, and some States don't regulate it at all.

One case that illustrates the potential for both insurance and securities fraud is the Liberte Capital case in Ohio. Last month, 17

people associated with a viatical settlement company, Liberte Capital Group, were indicted on 160 counts of fraud, money laundering, and other illegal acts. The defendants allegedly bought insurance policies that were actually invalid because of hidden medical conditions, then sold them to investors. When the insurance companies that originally wrote the policies found out about the medical problems, they canceled the policies, leaving the investors holding worthless paper.

Prosecutors say the investors lost nearly $105 million between 1996 and 2000. On top of that, Liberte Capital's accountant allegedly embezzled millions from the firm's escrow account that should have been used to pay premiums and the investors.

In Texas alone, State authorities have obtained criminal convictions in 13 separate multimillion-dollar viatical cases since 2000, and just yesterday, the SEC announced that it has filed a lawsuit in Texas against a new scam that defrauded more than 480 elderly investors out of over $30 million.

There are important questions for the Financial Services Committee to consider about viaticals:

Is there sufficient coordination between insurance regulators, securities regulators, and law enforcement officials to ensure that viatical fraud can be prosecuted, and, better yet, prevented?

Is there consistent regulatory treatment of viaticals by States, or should this subcommittee consider mandating some uniformity in treatment?

In this regard, I, in particular, and we as a subcommittee want to thank our colleague, Representative Mike Rogers from Michigan, who was instrumental in drafting H.R. 1408, the Financial Services Antifraud Act, to enable law enforcement to share critical information. The bill easily passed the House last year, but unfortunately, remains stuck in the Senate.

Representative Rogers planned to be here, but he is stuck in a snowstorm in Detroit.

Ohio is showing the way for other States grappling with viatical fraud. It recently passed a comprehensive law that addresses both the insurance and the securities aspects of a viatical settlement. Our witnesses today can discuss the impact of that law and the Liberte case, the extent of fraud in the industry and the implications for the future regulation of viatical settlements. We will hear from senior officials from the State of Ohio, a criminal investigator involved in the case, two attorneys with experience and expertise in this area, and an industry representative with experience in securities litigation. We will thank them for their attendance and we do look forward to their testimony.

I would like to inform the Members who are here that it is my intention to enforce the rule that limits statements and questions to 5 minutes each. And I would appreciate their cooperation in this.

And I turn now—Mr. Gutierrez is not here, but since I have spoken, I am going to turn to Ms. Jones, who was the first to arrive from the Democratic side.

[The prepared statement of Hon. Sue W. Kelly can be found on page 26 in the appendix.]

Mrs. Jones.

Mrs. JONES. There is something about being on time; I get to be Ranking, with not much seniority.

Good afternoon to Chairwoman Kelly, Ranking Members, in absentia, other Members of the Oversight subcommittee. I seek unanimous consent that my statement be included in the record.

We are here to hear from various witnesses this afternoon concerning retirement protection as well as fighting fraud. We have heard horror stories of Georgia dealing with crematories, and now we read about investment fraud with the viatical settlement. It is appropriate for this subcommittee to take up this matter and seek solutions that will prevent injury to consumers, investors, insurance companies, and families who face trying times with terminally ill family members.

I would like to, since I am from the State of Ohio, welcome our first witness, J. Lee Covington, the Director of the Ohio Department of Insurance. I am pleased that he is here to present regulations passed by the Ohio legislature to provide greater protection and regulation in this area.

And to our other distinguished panelists, even though you are not Buckeyes, we are glad to have you here to testify.

Retirement protection, as we have seen with the declining economy, as well as with the Enron case, is critical and has received heightened review. One area of retirement protection that has received tremendous attention is the viatical settlements. This industry has grown tremendously since 1990.

And I will just enter the rest of my statement for the record. I am just pleased to have an opportunity to be here, Madam Chairwoman, and would like to say to the members of the panel and my colleagues, I am scheduled to be on a panel at American University this afternoon with some law students over there, so I will be leaving early, but it does not diminish my interest in this area.

I also for the record, Madam Chairwoman, would like to put into the record a question that I would hope that members of this panel will address, and that is the question as to who, in fact, owns the insurance policy once it is sold? Is the insurance policy owned by the individual who actually purchased that policy or is it owned by those who subsequently have an opportunity to, for lack of a better term, "negotiate" the policy?

I would hope that as we go through this process, we will attempt to address that issue in our discussions, and I would hope that members of the panel would address that issue as well.

Again, Mr. Covington, welcome to Washington, DC. And if I have any time left, I yield the balance of my time.

Chairwoman KELLY. Thank you, Mrs. Jones. And with the unanimous consent of the subcommittee, we will insert that question in the record, and if we do not have time to verbally get a response, we will ask for a written response.

I would like to now go to Mr. Tiberi, who actually is the man who represents, I understand, Mr. Covington and Mr. Geyer, and perhaps you would like to introduce these people, Mr. Tiberi.

Mr. TIBERI. Well, I will allow my colleague from Ohio, who is a former Chairman of the Insurance Committee, to introduce one of the members. But it is great that you are having this hearing today, Madam Chairwoman. I am pleased that my plane was not

canceled in Columbus, the snow was starting there, but it is great to have the panelists here.

And I have got to tell you, Madam Chairwoman, the subcommittee is in store for, at least from two members, some outstanding testimony. I had the privilege to work with both Mr. Geyer and Mr. Covington when I was in the legislature. I think you will find them both to be pros, not taking anything away from the other members of the panel.

This is an important issue. Ohio has dealt with it in a strong, bipartisan way. And I think they have provided the leadership for other States as well.

With that, I know Mr. Ney has an opening statement, So I will allow him, if I could, to have the balance of my time.

Chairwoman KELLY. By all means. I understand that Mr. Gutierrez and I are surrounded by Ohioans, so we will let you all speak.

Mr. NEY. Thank you. I wasn't stuck in the snow either. As you can tell, I was a little bit south, more toward San Juan, Puerto Rico, and so I got a little bit of sun. But I am back, and I just wanted to take a second to actually commend both gentlemen, the entire panel, but obviously, Commissioner Lee Covington and Securities Commissioner Tom Geyer. They are both part of a superb regulatory team. I think the State of Ohio—I chaired the Insurance Committee in the Senate. We had great leaders there, too, as part of our regulatory team that has continued to this day.

So I just, Madam Chairwoman, want to say that I think we are one of the better regulated States in the Nation when it comes to financial services, providing the people of Ohio with stable and tenable financial markets. And also Lee Covington and Tom Geyer are both nationally recognized as being in the forefront of their fields. The case of Liberte Capital and their working in uncovering the rampant fraud in that company is a perfect example of their hard work, skill, and dedication.

So, I am happy to be able to commend both of you and introduce you.

Mrs. JONES. Mr. Ney, would you yield just a moment for me, please?

Mr. NEY. Yes, ma'am.

Mrs. JONES. Mr. Geyer, please forgive me. I did not want to not recognize you. You didn't come see me. No, I am kidding. All joking aside, I just to want to welcome you as well. I apologize.

Thank you.

Chairwoman KELLY. Thank you.

Mr. Tiberi, do you have an opening statement?

Mr. TIBERI. No, I will go ahead and introduce two of the guests whenever you would like.

Chairwoman KELLY. By all means. Let me let you do that, because then I will go to Mr. Gutierrez for his opening statement.

Mr. TIBERI Just briefly introducing the two Ohioans, Madam Chairwoman. Mr. Covington, as you have already heard, is the Director of Insurance in the State of Ohio, having been appointed by Governor Bob Taft in March of 1999. In his first 2 years, Director Covington has worked to reorganize the Department and retool it, retool the financial regulations of the Ohio Department of Insurance, after receiving some of the highest scores at the National As-

sociation of Insurance Commissioners accreditation review team in 2001.

He is considered one of the best in the country at what he does. He worked to pass the governor's patient protection bill and initiated a comprehensive health insurance prompt pay review to improve the speed at which consumers and providers receive health insurance payments.

Director Covington has been recognized nationally for his efforts in insurance regulation and featured regionally for his work to modernize insurance regulation in Ohio and across the country. And he lives in the congressional district that I represent. Thank you for being here today, Director Covington.

Assistant Director Geyer, prior to his appointment to the Department of Commerce as the Assistant Director, served as commissioner for the Ohio Division of Securities from 1996 to 2000, partly under former Governor Voinovich and now under Governor Taft. He received his Bachelor's degree from the University of Notre Dame and his law degree from the Ohio State University. He also serves as a Professor at Capital Law University in Columbus, Ohio.

Thank you, Madam Chairwoman.

Chairwoman KELLY. Thank you very much.

Mr. Gutierrez.

Mr. GUTIERREZ. I would like to submit my opening statement for the record so that we can proceed directly to the testimony of the witnesses.

[The prepared statement of Hon. Luis V. Guiterrez can be found on page 30 in the appendix.]

Chairwoman KELLY. Thank you very much.

Mr. Cantor, have you an opening statement?

Mr. CANTOR. Madam Chairwoman, not at this time.

Chairwoman KELLY. Thank you very much. If there are no more opening statements, then I would like to just quickly introduce the rest of the members of the panel. We have heard that Mr. Covington is the Director of the Ohio Department of Insurance and one of the Nation's leading insurance experts who has testified often before the subcommittee.

Next we have Mr. Greg Beriault, Fraud Team Leader from the Indianapolis field office of the U.S. Postal Inspection Service, who had a major role in the Liberte Capital case.

And Steven Mercer comes next. He is from the local law firm of Sandler & Mercer, an expert and author of a handbook used by the DC Bar.

And following him we have Mr. John W. Lazar, the Class Representative in the class action suit against Liberte Capital. And we understand that his attorney, Gerald Kowalski, is here with him today.

And David Lewis follows him, General Counsel of Stonestreet Financial, another expert speaking on behalf of the life settlement industry.

Following him will be Thomas Geyer, the Assistant Director of Commerce for the State of Ohio, former Commissioner of Securities, and another national leader in his field.

We thank all of you for joining us here today, and we appreciate the fact you are willing to share your thoughts and expertise with this subcommittee.

Without objection, your written statements and any attachments will be made part of the record. You will each now be recognized for a 5-minute summary of your testimony. There are lights in front of you, right here, that will indicate how much time you have. The green light signifies you are in the first 4 minutes of your summary, the yellow light will turn when you have 1 minute remaining, and the red light will turn when your time has expired. I would appreciate your trying to keep track of the time so that we can fit all of the Members' questions in as well. And, Members, I would remind you that I will also hold your questioning periods to the 5-minute rule.

We begin with Mr. Covington.

**STATEMENT OF HON. J. LEE COVINGTON II, DIRECTOR, OHIO DEPARTMENT OF INSURANCE**

Mr. COVINGTON. Madam Chairwoman, Members of the subcommittee, thank you very much for the opportunity to be here today to address the problem of viatical fraud and the steps that I have taken to combat this type of insurance fraud in the State of Ohio.

I commend the Chair and the subcommittee for your interest in this important issue. I thank the subcommittee and the House of Representatives for its favorable action on Chairman Oxley's Financial Services Antifraud Network Act of 2001.

Because the Chair has done such an excellent job of describing how viaticals work, I will not provide another explanation, but will reserve that to questions. I will note there is a very good chart in the back of my formal testimony. I may help you walk through that, because it is somewhat complex.

I will highlight again that the social benefit of viaticals may be extremely valuable for some terminally ill persons and senior citizens. The money obtained through those transactions can be used for anything from experimental medical treatments not covered by insurance to paying off accumulated bills.

Unfortunately, fraud jeopardizes the very existence of this industry. In the largest fraud investigation ever undertaken in the history of the Ohio Department of Insurance, we uncovered a scheme that defrauded over 3,000 victims of more than $100 million. Our joint investigation with several Federal agencies, including the United States Postal Service, resulted in the indictment of 15 individuals who fraudulently obtained multiple life insurance policies, and the indictment of the owner of Liberte Capital Group, a Toledo area viatical settlement company.

In this case, viators fraudulently obtained insurance policies by lying about their bad health conditions or conspiring to have other persons take required blood tests and/or physicals.

Because of this investigation, 85 insurance companies were able to rescind most of the fraudulent policies, saving the companies more than $25 million. The victims of this fraud are both investors and insurance companies and these companies' legitimate cus-

tomers who end up paying more through higher insurance premiums.

In addition to our aggressive antifraud criminal investigation efforts, the Ohio Department of Insurance has been active on the legislative front as well, developing and working on a new law to prevent this type of fraud.

In January of 2001, Ohio passed legislation based on the model developed by and adopted by the National Association of Insurance Commissioners in March of 2001, and I am proud to report that Ohio was the first State to adopt this model. This new law creates criminal penalties and gives the department the authority to request an injunction ordering the immediate termination of any potentially harmful activities during an investigation which can prevent or limit the scope of damages and the number of victims.

It prohibits viatical settlements within 2 years of issuing a life insurance policy unless the individual meets one of four legitimate exceptions.

Third, it requires a notice to the insurer of any viatical settlement which allows an insurance company to examine the policy for potential fraud and, if present, to rescind the policy very early on in the process.

And fourth, it clarifies that viatical settlement transactions are securities under Ohio law and are subject to all regulations associated with securities.

Although I have focused on Ohio's activities and accomplishments, I know this is a high priority for other States. At least 12 other States have or have pending bills and regulations to update their laws by adopting the 2001 NAIC model. A majority of States, 29, have similar laws and are expected to determine if they need to revise their current laws to provide additional protections against insurance fraud.

State insurance regulators, through the NAIC, also acted previously to protect terminally ill through consumer protections, including model laws adopted in 1993 and 1998. Unfortunately, until 1999, when John Hancock Insurance Company took the first court action to rescind fraudulent policies, no one ever knew that these transactions would be adulterated by the acts of criminals ready to perpetrate fraud. In a little over a year, the NAIC took action and the Ohio Department took action to put in place protections for this type of fraud.

Congress can help State regulators in our effort to combat insurance fraud, and the House of Representatives has already done so by passing Chairman Oxley's Financial Services Antifraud Network Act of 2001. This bill is a giant step forward, and I strongly support immediate action in the U.S. Senate to pass this legislation.

This legislation will be extremely beneficial, because it provides State regulators access to an existing network of criminal and administrative databases, including the Federal Bureau of Investigation's Antifraud database, and the actions that you referenced, Madam Chairwoman, that individual in Texas who had been previously barred by the SEC, and this will allow us to share information and to combat fraud more effectively across the country.

According to the Coalition Against Insurance Fraud, insurance fraud costs American families almost $1,000 a year in extra pre-

miums. It is a tax imposed on each American by criminals, and we must do everything we can do to stop this action.

I see that my time is out, and I will be happy to answer questions at the appropriate time. Thank you, Madam Chairwoman.

[The prepared statement of Hon. Jay Lee Covington II can be found on page 46 in the appendix.]

Chairwoman KELLY. Well done, Mr. Covington. Thank you very much.

Let's go to Mr. Beriault.

**STATEMENT OF GREG BERIAULT, POSTAL INSPECTOR, FRAUD TEAM LEADER, INDIANAPOLIS FIELD OFFICE, U.S. POSTAL INSPECTION SERVICE**

Mr. BERIAULT. Good afternoon, Chairwoman Kelly, and distinguished Members of the subcommittee. I am Postal Inspector Greg Beriault, fraud team leader at the U.S. Postal Inspection Service's Indianapolis field office. Thank you for the opportunity to testify today on the mission of the Postal Inspection Service and our leadership role in the campaign to end viatical settlement fraud, a rising menace to consumers, the insurance industry, and law enforcement.

Mail fraud investigations are often broad in scope and typically involve members of the American public as victims. One such fraud I have become involved with is viatical settlement fraud. The victims of viatical settlement fraud include the public, who are investors, and the insurance industry.

In May of 1999, members of the Postal Inspection Service's Indianapolis field office fraud team were made aware of a growing problem of fraud related to viatical settlements. Based upon discussions with the insurance community, law enforcement, and State regulatory agencies, it became apparent there was a need to address this issue. A working group of eight postal inspectors was established. This working group met in Indianapolis in August of 1999 to develop a plan for the Inspection Service's viatical fraud initiative.

In August of 1999, the U.S. Postal Inspection Service established a national task force responsible for developing a strategy for the successful identification, investigation, and prosecution of individuals involved in this fraud. The task force worked from the Indianapolis field office and was named Operation "Clean Sheet." In November of 1999, the task force became a joint investigative effort with the FBI, and has also worked closely with the other State law enforcement and regulatory agencies.

Through analysis of the intelligence gathered, the OCS task force was able to identify many of the major offenders and assist law enforcement in identifying targets. The OCS task force was responsible for initiating, coordinating, and supporting these field investigations.

On May 19th, 2000, eight simultaneous search warrants were executed at various locations throughout the United States. Each search warrant was the result of investigations relative to the viatical settlement fraud. This effort involved more than 200 Federal, State, and local law enforcement officers.

The OCS task force was very successful in forging a cooperative effort among regulatory agencies and State and Federal law enforcement nationwide. There are approximately 40 known investigations nationwide. To date, there have been approximately 100 arrests and 75 convictions made relative to viatical settlement fraud. The majority of these investigations are still ongoing.

The Liberte Capital Group investigation in Ohio is a good example of the cooperative effort among State and Federal agencies. Agencies participating in this investigation include the U.S. Postal Inspection Service, Ohio Department of Insurance, Federal Bureau of Investigation, Internal Revenue Service and Department of Justice.

Due to the complexity of this fraud, a single case often involves an insured party, insurance agent, insurance company, viatical settlement company, viatical broker and investors, all living in different parts of the country. Therefore, various State and Federal jurisdictional boundaries are affected by these investigations.

Due to this dispersion, coordination with the Department of Justice and State prosecutorial authorities has been very instrumental in the successful prosecution of these cases. As with most fraud cases, senior citizens are often targeted by fraudsters and, unfortunately, end up as victims. Viatical settlement fraud is particularly insidious as it frequently entices its victims into investing their life savings.

The investment and viatical settlement also appeals to the humanitarian side of the investors. They perceive themselves as helping a terminally ill person pay for the medical attention needed and to live as comfortably as possible in their final days.

Another reason we believe that investors have become victims of this fraud so easily is that the life insurance industry is one of the oldest and most trusted industries in our Nation. For generations people have trusted in life insurance and faithfully paid their premiums, only to receive what was due upon the death of the insured. Most investors recognize the risks associated with speculative investments.

However, when you discuss life insurance, most people think of a safe, secure investment. The distinction between the insurance industry and the viatical settlement industry may not be fully appreciated or understood by most investors.

Finally, because of the nature of the fraud and the obvious need to keep information about the insured private, there is a reluctance by investors to follow up or ask a lot of questions about their investment. When the investment does not pay off due to the death of the insured, they are most often reluctant to complain, because in effect they are complaining that the insured did not die as projected.

The prevention efforts of the task force which focused primarily on identification and investigation, also included outreach to consumers protection groups, the insurance and business community, and oversight regulatory agencies. Although our efforts have had a significant impact in reducing the fraud in this industry, the Postal Inspection Service emphasizes the importance of consumer awareness and prevention as the best protection for customers.

There are many challenges facing law enforcement, regulatory agencies and insurance companies as they continue to combat and prevent fraud from occurring in the viatical settlement industry. In working as a task force leader, I have had the opportunity to talk with many individuals from the insurance industry, State regulatory agencies, prosecutors and law enforcement. There are certain issues that surfaced during each conversation. And these issues I would just state simply as follows.

I see I have run out of time here. But the primary issues that seem to come up and surface as you speak with prosecutors and law enforcement and the regulatory agencies, the main areas of concern are the life expectancy projections, the issue of insurable interest, and certainly a concern over the life settlement—which is now where most of these companies are headed toward is the life settlement—where we are talking about the senior settlements. Thank you.

[The prepared statement of Greg Beriault can be found on page 34 in the appendix.]

Chairwoman KELLY. Thank you very much, Mr. Beriault.

Let's go now to Mr. Mercer.

**STATEMENT OF STEPHEN B. MERCER, ESQ., ATTORNEY, SANDLER & MERCER, P.C.**

Mr. MERCER. Thank you. Good afternoon, Madam Chairwoman, and other Members of the panel. I am an attorney in private practice, as has already been recognized. And in 1992, I began to work with the Whitman-Walker Clinic, Legal Services Clinic, which is a local non-profit agency that provides many services to HIV and AIDS persons. And one of the areas that I have been working in is working with folks who were trying to sell their life insurance.

Now, the point that I want to stress for the panel is that, in reviewing the fraud in the industry, not to overlook how important these transactions can be for persons who are terminally ill. The money that is realized from these sales can go toward housing, food, medicine, and it keeps them off other programs that may use up resources that are very much needed for folks in their situations. So remember that these transactions are very important to persons living with HIV and AIDS, and that, in seeking to regulate out the fraud or the potential for fraud, that that can't be forgotten.

In my experience, what I generally have encountered—because most potential viators that are looking to engage in "clean sheeting" are not seeking the advice of attorneys—is the sort of day-to-day issues that confront viators that are looking to sell their policies. These are issues of confidentiality, these are issues of deceptive sales practices, and these are issues related to low prices that are partly due to the increased life expectancy of persons with HIV, but also resulting from scarce capital in the marketplace.

And while fraud has a lot to do with it, I also believe that the structure of the marketplace as it stands right now, where it is unregulated by Federal securities law, provides for a situation where the viatical settlement companies have absolutely every incentive to increase commissions, administrative charges and other fees, and they do not have any commonality of interest with the investor.

And so even the investor that isn't defrauded is not realizing a reasonable rate of return, which means there is less money for potential viators. And I believe the primary reason that the day-to-day investor is not seeing a good rate of return is because this is an area that should be subject to securities regulation, but is not. And there is a case that the panel I am sure is familiar with, *SEC* v. *Life Partners*, that should be corrected.

Information is vital to investors, and to achieve a commonality of interest between the viatical settlement companies and the investors, so that they both have a stake in the profitability of the transaction. Given the viatical settlement company, that stake should also give them incentive to fet out the fraud in the underlying transaction. And if you are not creating this match between one investor and one viator, then you are also serving to protect the confidentiality interest of the viator by removing that particular match.

In other words, I am essentially talking about providing—if these transactions are subject to securities regulations, then you are in a situation where viatical companies can pool the risks, avoid the uncertainties of an individual transaction, and strive for the predictability of many transactions so that qualified investors can have a reasonable rate of return, there can be more money in the marketplace for potential viators, and the overall structure of the market is fashioned in such a way to protect issues of confidentiality.

Just one other point I did make in my written statement, that if there is going to be proposed legislation about viatical settlements, there are also tax consequences that need to be considered. In 1996 Congress enacted as part of HIPAA some tax reforms to exempt the proceeds of many viatical settlements from income tax. But with the advancing treatments of HIV/AIDS, sort of the carving out of the income tax for viatical settlements has now largely disappeared, because folks are living more than 2 years, and many of the prices are not coming up to the minimum pricing standards of the NAIC, and so you have viatical transactions now subject to income tax. And that should be something that should also be considered. Thank you.

[The prepared statement of Stephen B. Mercer Esq. can be found on page 71 in the appendix.]

Chairwoman KELLY. Thank you very much, Mr. Mercer.

Now, Mr. Lazar.

**STATEMENT OF JOHN W. LAZAR, CLASS REPRESENTATIVE IN LAWSUIT AGAINST LIBERTE CAPITAL CORP.**

Mr LAZAR. Ladies and gentlemen, I am John Wayne Lazar, 78 years old, and a resident of Clinton Township, Michigan. I was born and raised in the Detroit area. I am a widower, and I have two sons and five wonderful grandchildren.

I proudly served my country in the Navy between 1943 and 1945. After my military service, I earned a bachelor's degree in industrial engineering from Lawrence Institute of Technology. For 40 years I worked in the automotive industry in various engineering and management positions. I retired in 1991 and moved to Florida to enjoy the retirement that I worked so hard for.

In approximately 1997, I began reading about viatical settlements. I read articles in the *Wall Street Journal* and even saw a favorable report on *60 Minutes*. I was quite interested in the use of viatical settlements for my retirement investments. I then contacted a number of viatical companies, obtained written material, and reviewed the material in detail. Viatical settlements were marketed as safe, secure, guaranteed, and humanitarian investments. I was assured that they were safer than CDs and provided a higher rate of return. Furthermore, I was told that an investment in a viatical settlement would assist individuals with AIDS and other terminal illnesses who were in desperate need of financial help during the last days of their life. I was told that this was a noble investment.

After carefully reviewing the investment material, I decided to invest nearly all of my retirement savings, consisting of approximately $120,000 in an IRA and $50,000 in other savings. Because of the living uncertainty of this type of investment, I elected to invest this money in Liberte Capital for only 1 year. I was guaranteed a return of 14 percent, paid in quarterly installments.

I received three quarterly interest payments and no more. My principal has never been returned. I have moved back to Michigan, back to Clinton Township, to be close to one of my sons. I presently live on my monthly Social Security payment and the interest I am earning as a result of the sale of my home in Florida.

Needless to say, my financial situation has been devastated by the fraudulent activities of Liberte Capital. I am a class representative in a lawsuit that has been filed to recoup our investments. My attorneys have advised that at best we can expect only a small portion of our investments to be returned. As a class representative, I have spoken to Liberte Capital investors across the country. Most Liberte Capital investors are senior citizens who like me invested all or a significant portion of their life savings.

Many of these investors have had to sell their homes and move into apartments in order to make ends meet. Other investors have had to return to the work force. Some investors forgo the amenities which they planned for and struggle to afford the necessities of daily living such as utilities, food, and medical care.

I am attaching to this statement a few letters from investors that have accurately portrayed their situations. I could attach hundreds more such letters.

I am also attaching an article that appeared recently in the Toledo, Ohio newspaper, *The Blade*, which explains the devastating impact that the fraudulent activities of the Liberte Capital have had on a small town in Indiana.

I thank you for the opportunity to appear before you today. On behalf of all of the Liberte investors, I request your help in dealing with this devastating situation. In addition to this statement, I would like also to submit a statement prepared by my attorneys, Andy Storer and Jy Kowalski. Thank you.

[The prepared statement of John W. Lazar can be found on page 63 in the appendix.]

Chairwoman KELLY. Thank you, Mr. Lazar. My heart just absolutely hurts for you and the other people who are caught in the same situation.

Let's go to Mr. Lewis.

**STATEMENT OF DAVID M. LEWIS, ESQ., PRESIDENT, LIFE SETTLEMENT INSTITUTE**

Mr. LEWIS. Thank you. Good afternoon. My name is David Lewis, and I am appearing before the subcommittee today in my capacity as President of the Life Settlement Institute. By way of background, I have been a practicing Attorney for 31 years, including 4 years as a Staff Attorney in the Division of Enforcement of the SEC.

The Life Settlement Institute is a trade association whose members are institutionally funded life settlement providers and financing entities. Life Settlement Institute members do not use private investor funds to purchase policies, but instead solely use financing provided by banks, insurance companies, and institutional sources of capital.

As an aside, Life Settlement Institute members have worked with the trustee in the Liberte case to purchase policies from the bankruptcy estate. These funds will be used to cover at least some of the investor losses.

Viatical life settlements provide meaningful alternatives to persons facing terminal illnesses or who have life insurance policies they no longer want or can afford. A life settlement transaction, however, is different from a traditional viatical settlement. In a viatical settlement, the insured has a terminal illness and their life expectancy is normally estimated to be 2 years or less. The transaction is designed to provide needed funds to assist persons with short life expectancies in improving the quality of their life.

In a life settlement, the insured is a senior citizen who is over the age of 65, does not have a terminal illness, has an estimated life expectancy of up to 12 years. A life settlement gives policyholders a new option to consider in their financial planning. Typically a person who has a life insurance policy they no longer want or need can do one of two things: one, stop paying the premium and let the policy lapse; or, two, surrender the policy to the issuing insurance company for the cash surrender value.

As you may know, a majority of life insurance policies held by persons over the age of 65 merely lapse with no value to the insured. A life settlement allows the senior citizen owner of the policy to obtain more value for their policy than they could receive from the issuing insurance company.

I would like to share with you some examples of the benefits of life settlement transactions to seniors. One of our members recently closed on a transaction with a 69-year-old male from Pennsylvania who had a $500,000 term life policy where he could not afford the renewal premiums. He had an estimated life expectancy of approximately 7 years. The policy had no cash value. The Life Settlement Institute member was able to pay the senior $100,000 for his policy, and the senior used the proceeds to pay for his long-term care needs.

In another recent transaction, a member purchased a $750,000 universal life policy from a 72-year-old female from New Jersey who had an estimated life expectancy of 6 years. The policy had a cash surrender value of $40,000. The member was able to pay the

senior $165,000, and the funds enabled her and her husband to stay in their family home.

These examples and many others that we could provide demonstrate the value to seniors of the availability of this new financial option.

At the present time 35 States regulate, through their insurance regulators, traditional viatical transactions. And of that group, approximately 13 also regulate life settlements. Only approximately 20 States regulate the sale of viatical or life settlements to private investors. In most cases, this regulation is through their securities regulators. Last year, the NAIC promulgated its Viatical Settlements model act. The "model act" regulates both traditional viatical settlements and life settlements.

The Life Settlement Institute and its members have worked closely with the NAIC viatical working group that developed the model act, and we commend Commissioner Dunlap of Louisiana, the chair, and the other working group members for their diligent efforts.

The alleged fraud resulting in the Liberte case and others like it around the country were not caused by anything inherently wrong in a viatical or life settlement transaction, but were caused by persons taking advantage of a perceived regulatory vacuum, which vacuum is largely the result of the life partners case mentioned by Mr. Mercer, and this allowed these con artists to practice their scheme on an unsuspecting public.

There is nothing new about the fraud in the Liberte case. When I was a young lawyer working at the SEC in the 1970s, the Enron of its day was a case called Equity Funding, in which a large public company cooked its books by creating phony life insurance policies that it resold to reinsurance companies.

We applaud the efforts of Ohio regulators and those elsewhere who are cracking down on fraudulent activities. Increased regulation and the enforcement thereof will minimize if not eliminate these abusive activities. The abuses highlighted in the Liberte case, which is fraud in the sale of viatical policies to private investors and fraud with respect to obtaining life insurance policies, can be, we believe, addressed in the future with the following initiatives.

First, on the Federal level, the amendment of the Federal Securities Act of 1933, so that the packaging and sale of interests in life insurance policies to private investors are deemed to be securities under that act and are regulated by the SEC. This legislation is needed to correct the current Federal case law on the subject, as mentioned by Mr. Mercer. The Federal securities laws have served the public and the Nation's businesses well over the years, and there is no reason to believe that they would not work just as well in regulating the sale of viatical or life settlements to private investors.

Second, on the State level, we urge the passage in every State of legislation patterned after the NAIC model act. The model act provides for strong regulation of the viatical settlement industry to be conducted by the Department of Insurance in each State.

Importantly, the model act also includes many provisions that strongly support the use of institutional funds for the purchase of life insurance policies.

Chairwoman KELLY. Mr. Lewis, I am sorry to intupt you, but you are out of time. You may sum up.

Mr. LEWIS. I am finished. It is another sentence. We just believe that the use of institutional funds with the stringent due diligence requirements that are attendant to its use is the best way to promote an industry that provides a valuable service to seniors and to protect such potentially vulnerable individuals from fraudulent businesses.

Thank you for allowing me to appear before you today. I would be pleased to answer any questions that the subcommittee Members have. Thank you.

[The prepared statement of David M. Lewis Esq. can be found on page 65 in the appendix.]

Chairwoman KELLY. Thank you very much. You understand that your full written statement has been made a part of the record.

We turn now to Mr. Geyer.

**STATEMENT OF THOMAS E. GEYER, ASSISTANT DIRECTOR, OHIO DEPARTMENT OF COMMERCE**

Mr. GEYER. Thank you, Chairwoman Kelly. And, Mr. Tiberi, thank you for that kind introduction. It is a privilege to be here this afternoon to talk about the securities law aspects of viatical settlements. And as you have heard from the previous witnesses, the securities component arises when the viatical settlement provider or other company solicits investors to provide money to fund the payout to the insured. The investor is induced to invest, with the promise that they will receive the death benefit or a fraction of the death benefit in an amount that exceeds their original investments.

This creates a return on the investment. And in securities law, we call this type of arrangement an investment contract, which is a type of security. Once a transaction constitutes a security, securities laws impose three requirements:

First, people selling securities must be licensed or properly exempted from licensure.

Second, the securities product itself must be registered or properly exempted from registration.

And third, there must be full and fair disclosure of all material terms and conditions of the transaction.

This three-part framework of oversight provides essential investor protections. Unfortunately, in some cases investors in viaticals have not had the benefit of these protections because viaticals have proven to be fertile ground for fraud and other securities law violations.

In Ohio alone, we initiated our first securities enforcement action in June of 1998. Since that time we have initiated 30 actions, 26 of which have been finalized. All of those final actions have found that the viatical product was not properly registered, or exempted from registration, meaning there was no compliance with the laws requiring full and fair disclosure.

Half of the cases have involved the unlicensed sale of securities, meaning that the person consummating the transaction had no assurance that that person had any competency with respect to financial or investment matters, and one in five has involved

misstatements or omissions of material facts. And examples of common omissions and misstatements are included in my written statement.

In addition to our enforcement efforts, we also focus on investor education. We think it is very important to help educate Ohioans, put them in a position to make informed investment decisions. Among our resources we offer a 1–800 investor hotline, a searchable database on our website, numerous brochures, and dozens of educational programs each year. We believe it is essential that investors educate themselves as more and more investment opportunities are available to them.

Our experience with securities law violations in Ohio is in no way unique. In 1999, the North American Securities Administrators Association, NASAA, named viaticals as one of the country's top 10 financial scams.

As you can see from the chart, 34 States' security regulators do assert jurisdiction over viatical products as securities. There is some level of uniformity among the States, although obviously more can be done. I would caution however, though, in some of those States perhaps the insurance regulator has sole jurisdiction over the viatical, perhaps prohibiting the security regulator from asserting jurisdiction.

But uniformity is critical. Certainly it maximizes investor protection, but it also promotes fairness, because businesses know the rules of the game, and no State will become a haven for scofflaws.

Returning to a discussion of our experience in Ohio, as Mr. Covington pointed out, the Department of Commerce worked closely with the Department of Insurance to sponsor the Ohio legislation, House Bill 551. To my knowledge, 551 is the first single comprehensive bill that addressed both the State securities law and the State insurance aspects of viaticals.

It represented a wonderful level of regulatory cooperation, and I think this cooperation is essential as we move forward into this new financial marketplace. Federal legislation, like H.R. 1408 that provides the tools to regulators, go a long way to establishing cooperation and giving them the tools to prevent fraud.

Just to conclude, whether you believe viaticals are socially valuable or whether you think they are abhorrent, because they derive their return from death, the fact is that they are here, and we must continue to help our citizens educate themselves so that they can make informed investment decisions. Meaningful regulation is essential to ensure that neither viators nor investors are defrauded.

As demonstrated in Ohio, there is an opportunity for functional regulation and cooperation among regulators. And the regulators, along with the legislative bodies, must remain vigilant to ensure that the viaticals marketplace is one characterized by full disclosure, the absence of fraud, fair payouts to viators, and fair returns to investors.

Thank you very much.

[The prepared statement of Thomas E. Geyer can be found on page 57 in the appendix.]

Chairwoman KELLY. We thank you very much.

I also want to thank David Epstein and Robert Gordon for producing this chart that we have over here. They are the staffers who put this together. And I find it fascinating in this chart that if you look at it you can see that the regulations, the laws, are such a patchwork all across the United States. Wyoming has an F, but so does Rhode Island. So it is all the way across the United States. Georgia and Hawaii all arrive at an F. On the other hand, Alaska has an A-plus. And you go back and find Nevada with an A-plus.

[The information referred to can be found on page 80 of the appendix.]

So for seniors across the Nation, and for senior groups across the Nation, it has got to be very difficult to advise seniors with regard to what could otherwise be a logical investment for them.

Also, as in Mr. Lazar's case, he was trying to do something to help people. And I think it is one of the important reasons why we are having this hearing today. We need to have some kind of uniformity so that everyone understands. And obviously, it sounds to me from your testimony as though what we also need is transparency.

I would like to just start the questioning by saying that—turning to you, Mr. Geyer, and going on with that—my original statement. Can you give me any reason why we have some States that are regulating viaticals as securities and others that aren't? And the courts seem to be all over the map on this one.

Mr. GEYER. Madam Chairwoman, I wish I could give you a real good answer. The best answer I can give you is, again, States serving as the laboratory of regulation. And in some States you may have a strong insurance regulator, and the legislature has decided that the insurance commissioner or the insurance department should oversee both the insurance side as well as when viaticals are sold to investors.

I think that is the case at least in Connecticut and perhaps a couple of other States as well. Other States where you perhaps have a division of labor between the State securities administrator and the insurance regulators, that is where you have seen the State securities people step forward.

I think confusion has also been heightened because of the Life Partners decision. Many people assume that since a viatical is not a security under Federal law, the assumption is it is not a security under State law. Of course, that is not the case. We have a complementary set of regulations. So if regulation is going to be maintained on the State level, we certainly need to improve the uniformity and we need to improve the cooperation between securities and insurance regulators.

Chairwoman KELLY. I would like to ask that same question of you, Mr. Covington. There are 15 States that appear not to have any regulation at all, and they obviously missed the boat in 1993, they missed the boat again in 1998, and I don't think that they have passed any act in 2001. We haven't passed that act, it is sitting over in the Senate.

I am interested that those 15 States have no financial licensing requirements, no antifraud provisions, and no advertising standards. When the NAIC does good work and Ohio responds like this immediately, why is it so hard to get other States to respond?

Mr. COVINGTON. Madam Chairwoman, I obviously can't speak for the conditions of the situation in each of those States. I can tell you that we see patterns where there is greater abuse. For example, in the fraud area, we have seen a lot of activity in Ohio and Florida, Texas, California, and unfortunately sometimes in the legislative process it takes something bad to happen before people act.

So different States may have different levels of activity in this area, and I would commend the NAIC for acting very, very quickly when we discovered this type of fraud was occurring in 1999, and frankly, in just a little over a year, formally adopted a model law, and then States acted on that very quickly.

One of the issues with that was that the law was passed in the late part of the year, December, March, and a lot of legislative sessions had completed their work by that time. So that may be an explanation as well, but I think it has to do more with the activity that has been seen in those States.

Chairwoman KELLY. I want to go again, Mr. Covington, to you and just simply I thank you for your testimony in support of the antifraud bill that we passed. The GAO has given us several names of viatical fraud artists who had previous criminal convictions, like that guy in Texas, but particularly since the viaticals are a crossover insurance securities product, isn't it just plain common sense that the regulators and the law enforcement agencies should have access to the viatical agent's past disciplinary and criminal records to protect the consumers? It seems to me like that is just common sense.

Mr. COVINGTON. Madam Chairwoman, this will be my shortest answer. Absolutely.

Chairwoman KELLY. Any of the rest of you want to join in on that comment? Do you feel the same way, Mr. Geyer?

Mr. GEYER. Yes, ma'am. Again, to the extent that we can coordinate our efforts, I know that like the NAIC, the securities regulators have the trade group NASAA, and we work very hard on uniformity, and the more that we can tap into mutual databases and share information, the better off we will be to protect those in the marketplace.

Chairwoman KELLY. I want to ask one final question, because my time is almost out. Mr. Covington testified that the insurance fraud cost American families almost $1,000 a year and Mr. Beriault and Mr. Lazar noted that our elderly and seniors in particular are vulnerable targets for fraud artists. Have your offices undertaken an educational effort with seniors groups about viaticals, and how can we in Congress work with you to promote better retirement protection for seniors?

Mr. COVINGTON. Madam Chairwoman, there are a number of things that we have done to educate seniors. In the State of Ohio and in many States, most States I think, there is a senior health insurance program that is supported by the Congress. There is Federal funding matched in many States, including Ohio, that provides funding. So one thing that we would advocate is to continue that funding. We have seen a reduction in that funding, which hampers our ability to educate seniors. We have in Ohio over 1,400 volunteers in all 88 counties, and last year alone, we educated over 340,000 seniors, about 35,000 of those one-on-one. We have a

website that they can access, and in addition to that, one of the things that you are seeing today—now, some may say seniors don't use the website, but we are seeing more seniors do that. And second, seniors' children want to get online and be able to access that for their seniors. And we are seeing an increased activity. We have 11,000 people who visit our website every week.

So those are some of the things that we can do to educate seniors, and the Congress can help us do that.

Chairwoman KELLY. Thanks. Mr. Beriault, do you want to answer that question?

Mr. BERIAULT. Yes, as part of the task force, we recognize the importance of educating the public and certainly the seniors, and we were successful in partnering with the AARP. And they did issue an article related to viatical settlement fraud which identified the risk to the investors, and we were most appreciative of that. It included our 1-800 number and provided—and my understanding was that that went to 20 million homes. So certainly, organizations like that are very helpful in getting the message out.

Chairwoman KELLY. Mr. Beriault, do you have a copy of that article so we can put it in as part of the record?

Mr. BERIAULT. I will get you a copy. I don't have one with me, but I will provide you with a copy.

Chairwoman KELLY. If you would do that, we would like to put that in as part of the record, please.

Mr. Geyer, do you want to jump in here?

Mr. GEYER. Yes, ma'am. Thank you. Similar to what Director Covington does in the Department of Insurance, Division of Securities makes outreach programs throughout the year. In particular, April of each month we designate as Investor Savings and Education Month, and we make presentations to help promote financial literacy. I have spoken from age groups ranging from second graders all the way to senior citizens, and certainly when we speak to seniors or groups like that will emphasize viatical settlements or other opportunities that they may be subject to. But I agree. Investor education is critical as more and more complex financial instruments become available to our citizens.

Chairwoman KELLY. Thank you very much. Let us go to Mr. Gutierrez.

Mr. GUTIERREZ. Thank you. Mr. Mercer, what can the Federal Government do to prevent abuses in the viatical settlement workplace?

Mr. MERCER. Well, I think there are two areas. One has been touched on in terms of the relationship between the promoter and the investor by subjecting the sale of viatical investments to Federal securities law. Viators, whom I represent, have a stake in a robust viatical settlements marketplace, and to the extent that investors are experiencing and enjoying a reasonable rate of return on their investment because they are able to make a more informed decision about their investment, then that is going to benefit the folks that I work with.

And another point that I touched upon in my opening statement was looking again at the tax implications of viatical settlements, because the structuring of those tax rates back in 1996 now to a large extent are outdated, and you have folks that are selling their

policies and getting taxed on it, and, of course, there are now 1099s that accompany all of the transactions. So it adds another stress factor in their lives that are already filled with stress.

Now, another area, though, too has to do with the consumer protection side as it relates to viators. Now, in my experience representing viators in litigation that were harmed by abusive sales tactics of brokers, one of the problems that I encountered was that we did not have the benefit of consumer protection statutes, because, for example, in Maryland we were exempted because it was more in the nature of a service than a good, and yet although the NAIC has spearheaded much in the way of disclosure requirements early on in this emerging industry of viatical settlements, part of the problem is if you are in private litigation you are trying to go after the perpetrator and you have got a viator that maybe lives in Washington, works in Maryland and is dealing with a broker in Florida, and an ultimate purchaser that might be in another State, is you run into these conflicts about whether you are coming in under a State's model, you know, insurance regulation and whether you have to proceed by the filing of an administrative complaint with an insurance commissioner, whether you may have a private right of action under a State consumer protection statute that may provide for recoupment of attorney's fees and enforcement costs or liquidated damages.

So, there may be a component here also under Federal law of Federal consumer protection that may also help what are very frequently multi-State transactions; whereas, much insurance transactions are sort of State-to-State, where you have the in-State person dealing with a local State office. Viatical settlements for viators are very different. They are typically multi-State.

Mr. GUTIERREZ. Let me ask Mr. Covington or Mr. Lewis. Maybe somebody on the panel knows. Does viaticals fraud cost every purchaser of insurance $1,000 a year?

Mr. COVINGTON. Madam Chairwoman, Representative, that is all insurance fraud.

Mr. GUTIERREZ. I thought I was going to say a thousand bucks. That is a lot of money, almost what I pay for my whole insurance policy.

Mr. COVINGTON. But Madam Chairwoman, Representative, I might note that based on my understanding, a Florida grand jury found that over half of all viatical settlements involve some type of fraud. Now, I can't confirm that. I wasn't there, but reports that I have seen indicate that the grand jury, when I testified, this fraud really jeopardizes the very existence of this industry. I think we cannot have an industry that has that degree of fraud and deceit within it.

Mr. GUTIERREZ. I agree. Well, I think one of the things that—I am obviously, always concerned about insurance companies. That is why I ran for Congress, I was so concerned about them, and their bad rate of return. And the viaticals, that is the best-case scenario that Mr. Lewis gave us of somebody has a face value of $40,000 and someone generously gave them $160,000 for the $40,000, and 6 years when you put it in a pool, I mean, sometimes it is going to be less. Sometimes it is going to be more. If you actually regulate it like Mr. Mercer, there should be a lot of money to

be made. There is a $590,000 difference. Even a 10 percent return, it would take 15 years for that person to take that $160,000 and convert it into $750,000. So it seems to me that there could be a lot of people that could be benefited by these types of insurance, and if that is—I imagine, Mr. Lewis, you gave us your best case scenario. I have never seen an insurance industry spokesperson not give us their best case scenario as they come before these committees. So it seems to me that there is a lot of money and we probably could do a lot of good for a lot of people, if that is the best case scenario. Maybe we could do even better than $160,000, if we actually pooled and people saw a reasonable return and a greater level of safety.

Thank you, Mr. Chairwoman, for bringing this matter to the attention of this subcommittee.

Chairwoman KELLY. Thank you, Mr. Gutierrez.

Mr. Tiberi.

Mr. TIBERI. Thank you, Madam Chairwoman. My question is to all the witnesses here. Starting with Director Covington, do you think that we here in Congress should define a viatical settlement—change the law and define it as a security so the SEC can regulate it?

Mr. COVINGTON. Madam Chairwoman, Congressman, because I am not the expert on the securities side of this, I am not sure I am the best person to answer that question. So if I could, I will defer to the others on the panel. I don't know the intricacies of securities regulation between the State and Federal Government. I just know insurance.

Mr. TIBERI. It is just an opinion. We won't hold you to anything.

Mr. BERIAULT. I would just say that, you know, based on my experience with this industry and the amount of fraud that—and talking to the people in the industry, that certainly, that may be one of the best ways to get control of the industry and eliminate some of this fraud. Steps need to be taken so that there is full disclosure and that the investors recognize the risks that are involved in these investments, and that relates to the escrow accounts, full disclosures involving the escrow accounts, certainly full disclosure relating to the medical prognosis, methodology used, you know, who, in fact, is giving it, what is their track record, what is their confidence level, all of the things along these lines, are they—is it an arm's-length relationship with the viatical company. In some cases they are employees of the viatical company, in which case there is certainly a strong incentive to have aggressive mortality rates. Historical information about the annual rates of return. And all of these things seem to point toward some kind of security regulation. Financial statements, independent audits, all of these things I think need to be done to protect the investors.

Mr. TIBERI. Thank you.

Mr. Mercer.

Mr. MERCER. As I indicated earlier, I absolutely believe that a relationship between the promoter and the investor should be subject to Federal securities law. It is the classic situation where you have an investor solely depending upon the expertise of the promoter in making an investment decision, and the investor does not have information available through other means.

Mr. TIBERI. OK. Mr. Lazar.

Mr. LAZAR. Judging by what I have heard so far, there is no question in my mind that securitization is required and a necessity for conformity throughout the Nation; the same thing as regulated by the insurance companies should be regulated by viaticals. I don't see any difference between them. I just wonder if it works in reverse.

Mr. TIBERI. Thank you.

Mr. LEWIS. We strongly believe that an amendment to the Securities Act really makes a lot of sense, and would I think go the furthest and the quickest of cleaning up the investment side of problems in this industry. Clearly today the SEC regulates myriads—all kinds of—hundreds of different kinds of investments, and I think, you know, it is not free from problems, but it is proving to be a very effective system. And we strongly believe that that is the way that things—the quickest way I could think of to solve this problem.

Mr. TIBERI. Thank you.

Mr. GEYER. Madam Chairwoman, Mr. Tiberi, yes, not only would you then make the Federal disclosure laws applicable, the Federal antifraud standards become applicable. Then you also on the back end give tremendously more resources to the enforcement efforts against fraud in the viatical transaction. So, sure, I think that would be a tific step forward, again, if you are trying to make this a credible marketplace.

Mr. TIBERI. Just a follow-up to the panel, starting with you, Mr. Geyer. The antifraud bill that we passed here in the House that became law, how do you think that would deter fraud in this area?

Mr. GEYER. Madam Chairwoman, Mr. Tiberi, I think that would be a wonderful resource, because it would allow agencies when they are confronted either with a bad actor or a license applicant, to tap into a database and discover previous bad acts, discover criminal convictions. It is unfortunate that sometimes regulators operate in a vacuum, and the more we can share information the better off we would be.

Mr. TIBERI. Mr. Covington.

Mr. COVINGTON. I completely agree. I think that this is, as I said, a giant step forward in our abilities, providing us additional steps to combat fraud. So we strongly support immediate action by the Senate on this bill.

Mr. BERIAULT. Yes. I concur with both of these gentlemen. I think it would be an invaluable tool for investigators, and certainly in cases like viatical settlement fraud it would be of a great benefit to us in identifying who the major offenders are and what their past is and help us in our investigations.

Mr. TIBERI. Mr. Mercer, do you agree?

Mr. MERCER. Those certainly sound like reasonable comments, that the more disclosure you have and the more information, the more an informed decision can be made by an investor or by a viator.

Mr. TIBERI. Any other comments?

Mr. LEWIS. We would support conceptually—I am not really that familiar with the bill, but I must say our industry—the company I am connected with, we do intense background checks as best we

can on people we deal with to try and fet out if they have problems, and anything that will improve that system and make it more efficient and provide more information to legitimate users in the private world and for Government, it makes a lot of sense.

Mr. TIBERI. Thank you.

Chairwoman KELLY. Thank you, Mr. Tiberi.

Mr. Lazar, I know you have a plane to catch. I want to get you out of here so you don't have to feel stressed about that, but I want to ask you two quick questions. As a consumer, when you learned about viaticals in the *Wall Street Journal* or *60 Minutes*, did you know that they are subjected to totally different regulations in different States?

Mr. LAZAR. I was aware of it.

Chairwoman KELLY. You were aware of it?

Mr. LAZAR. Yeah.

Chairwoman KELLY. OK. I noted that Florida now has adopted the most recent comprehensive model law on viaticals, including licensing requirements, antifraud provisions and advertising standards. If this law had been in place in 1997 and you had known more about the risks of viaticals and the types of fraud that can occur, would you have acted differently?

Mr. LAZAR. Yes.

Chairwoman KELLY. Is this an area where you think we need to get all the States to have similar laws, to similarly improve their laws?

Mr. LAZAR. Oh, yeah.

Chairwoman KELLY. You think so?

Mr. LAZAR. Oh, yeah.

Chairwoman KELLY. Thank you very much. I want to thank all of the members of our panel. I do note that some people—Mike is not the only one who is stuck in an airport. There are several other Members. So I want to hold the hearing record open without objection for the next 30 days for Members to submit written questions to the witnesses so we can place their responses in the record.

This panel is excused with our great appreciation and thanks for your time, and I want to thank all the Members for all of their assistance in making the hearing possible. The hearing is adjourned.

[Whereupon, at 3:17 p.m., the hearing was adjourned.]

# A P P E N D I X

February 26, 2002

**Opening Statement**
**Chairwoman Sue Kelly**
**House Committee on Financial Services**
**Subcommittee on Oversight and Investigations**
**Hearing on Viatical Insurance Fraud**
**February 26, 2002**

Today we will examine a sector of the financial services industry that attempts to assist the elderly and terminally ill in meeting their financial obligations. Viatical settlements involve buying life insurance policies from the elderly or terminally ill individual at a discount and then marketing the policies as investments. In a proper transaction, the policyholder assigns the policy to a viatical settlement company for a percentage of the policy's face value. The settlement company then sells the policy to a third-party investor. The settlement company or the investor becomes the beneficiary to the policy, pays the premiums, and collects the face value of the policy after the original policyholder dies.

This industry began, in large measure, as a noble means of allowing AIDS patients to pay the costs of their steep medical bills before death. Unfortunately, bad actors have taken advantage of the situation to create or buy phony policies and then fraudulently bilk investors who expect a healthy return.

When you look at the viatical settlement industry, you see that viaticals start out as insurance policies, but end up as securities sold as investments. We have reviewed the status of viaticals regulation by the states, and as you can see from the chart on the stand, we have found that some treat viaticals as securities or insurance, some treat it as both, and some states don't regulate them at all.

One case that illustrates the potential for both insurance and securities fraud is the Liberte Capital case in Ohio. Last month, 17 people associated with a viatical settlement company, Liberte Capital Group, were indicted on 160 counts of fraud, money laundering, and other illegal acts. The defendants allegedly bought insurance policies that were actually invalid because of hidden medical conditions, and then sold them to

investors. When the insurance companies that originally write the policies found out about the medical problems, they cancelled the policies, leaving investors holding worthless paper. Prosecutors say the investors lost nearly $105 million between 1996 and 2000. On top of that, Liberte Capital's accountant allegedly embezzled millions from the firm's escrow account that should have been used to pay premiums and the investors.

In Texas alone, state authorities have obtained criminal convictions in 13 separate multi-million-dollar viatical cases since 2000. Just yesterday, the SEC announced that it has filed a lawsuit in Texas against a new scam that defrauded more than 480 mostly elderly investors out of over 30 million dollars.

There are important questions for the Financial Services Committee to consider about viaticals. Is there sufficient coordination between insurance regulators, securities regulators, and law enforcement officials to ensure that viatical fraud can be prosecuted, and better yet prevented? Is there consistent regulatory treatment of viaticals by states, or should this Committee consider mandating some uniformity in treatment? In this regard, we can thanks our colleague Rep. Mike Rogers of Michigan, who was instrumental in drafting H.R. 1408, the Financial Services Antifraud Act, to enable law enforcement to share critical information. The bill easily passed the House last year but remains stuck in the Senate. Rep. Rogers planned on being here, but is stuck in a snowstorm in Detroit.

Ohio is showing the way for other states grappling with viatical fraud. It recently passed a comprehensive law that addresses both the insurance and the securities aspects of a viatical settlement. Our witnesses today can discuss the impact of that law and the Liberte Capital case, the extent of fraud in the industry, and the implications for the future regulation of viatical settlements.

We will hear from senior officials from the State of Ohio, a criminal investigator involved in the case, two attorneys with experience and expertise in this area, and an industry representative with experience in securities litigation. We thank them for their attendance and look forward to their testimony.

I would like to inform the Members who are here that it is my intention to enforce the rule that limits their statements and questions to five minutes each, and I would appreciate their cooperation in this.

## Opening Statement
## Chairman Michael G. Oxley
## House Committee on Financial Services

## Subcommittee on Oversight and Investigations
## "Viatical Settlement Fraud"

## February 26, 2002

---

Today's hearing of the Subcommittee on Oversight and Investigations will review an important case of insurance and securities fraud uncovered and prosecuted in Ohio, and discuss what needs to be done to prevent such frauds from occurring in the future. I thank Chairwoman Kelly for calling this hearing and welcome our distinguished witnesses.

A properly conducted viatical transaction can benefit all parties involved. Policyholders receive the money they badly need to pay medical expenses; insurance companies that sold the original policies receive all required premiums; and investors and settlement companies who pool their funds to buy the policies make a return on their investment.

Unfortunately, all too often, con artists take advantage of the situation and leave investors holding the bag, giving legitimate settlement companies a black eye, and reducing the confidence that policyholders might have in the industry. In too many states, as we see from the table referred to by Chairwoman Kelly, the laws are either inconsistent or inadequate, with some states having no applicable regulations at all. This complete lack of uniformity in the State insurance laws, and the inexplicable gap in some states between the regulatory oversight of the insurance commissioner and securities regulator, is very troubling. I expect that this Committee will continue to look this year at how to protect consumers by improving the uniformity in State insurance laws and filling any regulatory gaps in cross-over or integrated financial products.

So I want to welcome our witnesses, who can highlight the way in which the great state of Ohio is dealing with such fraud. Lee Covington, the Insurance Commissioner for the State of Ohio, and Tom Geyer, the current Assistant Director of Commerce and former Securities Commissioner, are top-notch public servants who, together, prosecuted one of the largest viatical fraud rings, and helped enact one of the most balanced and comprehensive viatical laws in the country. Thanks to them, Ohio was the first state to pass the new model viatical settlement law proposed by the National Association of Insurance Commissioners, to complement Ohio's already strong securities consumer protections. We look forward to their expert and helpful testimony.

I expect this hearing will also highlight the need for better coordination among federal, state, and local law enforcement agencies to prevent crooks from moving from one industry to another in the financial services arena. Last year the House passed H.R. 1408, the Financial Services Antifraud Network Act, to establish an information-sharing network among the 250+ local, state and federal financial and law enforcement agencies. The network would allow regulators to more easily identify and track criminals moving across state lines and from industry-to-industry to protect Americans from terrorists and fraud.

Just yesterday, the SEC announced it had filed suit in Texas against a new viatical scam that defrauded more than 480 mostly elderly victims of over $30 million. The viatical ringleader had been previously barred from the securities industry for fraud (against mostly elderly victims). If the Antifraud Act had been in place, the Texas insurance regulator would have had this information and been able to stop the viatical fraud before another 480 elderly victims lost much of their life savings.

Unfortunately, this critically important weapon against fraud and financial terrorism, which passed the House by a 392-4 vote, is still being held with no action whatsoever in the Senate. We urge the Senate Majority Leader to let this bill come to the floor to give our law enforcement and financial regulators the tools they need to protect Americans against financial crime.

Again, I thank the Chairwoman for convening this hearing and our distinguished witnesses for testifying.

# OPENING STATEMENT OF
# LUIS V. GUTIERREZ
# RANKING DEMOCRAT
# SUBCOMMITTEE ON OVERSIGHT & INVESTIGATIONS
# "RETIREMENT PROTECTION: FIGHTING FRAUD IN THE SALE OF DEATH"
# FEBRUARY 26, 2002

---

Good afternoon Chairwoman Kelly and members of the subcommittee. Thank you for holding this important hearing that will help shed some light on a problem that has been largely overlooked by Congress and by many states in the U.S.

Thousands of people around the United States invest in this billion-dollar industry that is tainted with fraud yet unregulated by the federal government or until recently, by most states. Corruption in the viaticals industry was widespread in the mid-to late-90s. It's ironic that while a great number of people haven't even heard of the word viatical–these are one of the most common investment scams in the country.

I hope that with the information that will be gathered here today, we will be able to work together to ensure that viatical settlements can still occur while making sure that viators and investors are protected from fraudulent transactions.

Much of the current debate has centered on who should regulate viatical settlement investments--state insurance departments or state securities officials. In some states, this has created a situation in which state insurance codes regulate the viator/insurer transactions, while state securities officials work to ensure that no unregistered viatical settlements are ever offered to individual investors. Other states range from essentially no regulation at either end, to incongruous regulation between insurance and securities officials.

In the meantime, victims have lost hundreds of millions of dollars investing in fraudulent viatical settlements. Seniors seem to be the biggest victims. They have taken money out of IRAs or they have cashed in certificates of deposit (CDs) and they have converted to these investments and they have lost their life savings.

Viators are common victims of deceptive practices in these settlements. In many instances, they are so desperate for this cash that they act quickly–without information, without guidance. Often they don't know anything more than what viatical providers tell them. As a result, viators too often settle for unreasonably low offers–many times as low as 4% of the face value of their policies– to be able to get some relief from their medical expenses debt.

This vulnerable segment of our population urgently needs protection against fraudulent viatical settlements. They should obtain protection from clauses in settlement contracts that prohibit them from negotiating key terms such as those pertaining to confidentiality of medical records. We must ensure that medical information solicited or obtained by a provider or broker is kept confidential.

Also, viatical settlement clauses should provide disclosure requirements and other basic viator protections.

Investors on the other hand, have lost millions of dollars after the policies were cancelled because the agent who sold them the viaticals was not licensed. Some investors were led to believe their initial investment was all they had to put up. Then, they received letters from the viatical company telling them to pay annual premiums to continue the policy or they would lose their investment.

Madame Chairwoman--there is a need for such settlements. For terminally ill people, viatical settlements relieve financial distress. They use the funds for medical care, to save a family home from foreclosure, to pay children's medical expenses. For investors, viatical settlements mean potential for great profit while doing good for someone in need. Let's work together to find a meaningful solution to this critical problem for so many consumers around our nation to clear up areas of abuse, and restore confidence and legitimacy to this practice.

Thank you again Chairwoman Kelly for holding this hearing and I look forward to hearing all of the testimonies.

**Opening Statement of Rep. Stephanie Tubbs Jones**
**Before the Subcommittee on Oversight and Investigations**

Good Morning, Chairman Kelly, Ranking Member Gutierrez and Members of the Oversight subcommittee. Madame Chairwoman, I ask unanimous consent that my full statement be included in the Record.

Madame Chairwoman, we are here this morning to hear from various witnesses concerning retirement protection as well as fighting fraud. Many of us have heard of the horrors stories out of Georgia dealing with crematories and now read about investment fraud with viatical settlements. Thus, it is appropriate for this subcommittee to take up this matter and seek solutions that will thwart injury to consumers, investors, insurance companies and families who face trials times with terminally ill family members.

I am glad this afternoon to welcome our first witness, J. Lee Covington II, Director of the Ohio Department of Insurance. I am pleased that Director Covington is with us. Under his leadership, the state of Ohio has taken the lead with providing greater protection and regulation relative to viatical settlements and insurance. To our other distinguished panelists, I look forward to your testimony as well to better inform this subcommittee about the issues ahead.

Retirement protection, as we have seen, with a declining economy as well as with the Enron case, is critical and has received heightened review. One area of retirement protection that has received tremendous attention is viatical settlements.

The viatical settlement has grown tremendously since 1990. In 1990, approximately $80 million worth of life insurance was viaticated as compared to around $1 billion in 1999. However, with these increases, comes fraud.

Fraud has become rampant. It is estimated that 40-50% of the life insurance policies were procured by fraud. I hope that our panelists today will share their insight on this industry and how best we may be able to deal with the challenges that lie before us.

Madame Chairwoman, thank you again for the opportunity to present my remarks. I look forward to the testimony of the witnesses.

**The Honorable Mike Rogers of Michigan**
**Subcommittee on Oversight and Investigations**
**House Committee on Financial Services**
**February 26, 2002**

**Opening Statement**
**"Retirement Protection: Fighting fraud in the sale of death"**

First, I would like to thank Chairwoman Kelly for turning the Committee's attention to an industry that appears to be in need of heightened scrutiny. Second, I would like to welcome a fellow Michigander, Mr. John Wayne Lazar, to the Committee. Mr. Lazar, I look forward to hearing testimony regarding your experiences with Liberte Capital and its effect on you and your family.

During my brief time on the Committee, fighting financial services fraud has been a top personal priority. In fact, this Committee and the entire House of Representatives has made fighting financial services fraud a priority through its support of H.R. 1408, the Financial Services Antifraud Network Act.

This legislation, which the House approved 392-4, on November 6, 2001, moves to create an antifraud network for information sharing among the nation's more than 250 financial regulators about fraudulent actors in the financial services sector. Currently, bad actors can too easily escape regulators' notice by moving from one state to another or from one industry to another.

A prime example of the need for the Financial Services Antifraud Network Act comes from today's headlines. The Securities and Exchange Commission recently filed a new complaint in Texas against viatical fraud. The SEC's complaint alleges nearly $30 million in viatical fraud was perpetrated against more than 480 investors - most of whom were senior citizens. In fact, the accused viatical fraud artist previously had his securities license suspended for fraudulent acts. Because Texas regulates viaticals as an insurance product, had H.R. 1408 already been enacted into law, the Texas insurance regulators would have known of the previous securities license suspension and taken the appropriate steps to prevent the issuance of an insurance license that allowed the alleged viatical scheme to flourish.

Seamless information sharing to prevent financial fraud is the central focus of H.R. 1408. This legislation, which awaits Senate consideration, will help the financial regulators coordinate their antifraud efforts, particularly by coordinating computer protocols so that their systems can seamlessly communicate and share critical information.

As a former special agent for the FBI, I know firsthand that criminals come in all shapes and sizes. My experiences in law enforcement regarding fraud artists will be consistent with the testimony we will hear today: That modern-day financial fraud artists most often prey upon unsuspecting senior citizens and fleece them out of their life savings or retirement nest eggs.

Again, I thank Chairwoman Kelly for holding this important hearing, and look forward to continued work with my colleagues to get the Financial Services Antifraud Network Act through Congress and onto President Bush's desk for signature into law.

Thank you.

## Oversight and Investigations Subcommittee of the Financial Services Committee

## Viatical Fraud

Good afternoon Chairwoman Kelly and distinguished Members of the Subcommittee. I am Postal Inspector Greg Beriault, Fraud Team Leader at the U.S. Postal Inspection Service's Indianapolis Field Office. Thank you for the opportunity to testify today on the mission of the Postal Inspection Service, and our leadership role in the campaign to end viatical settlement fraud, a rising menace to consumers, the insurance industry, and law enforcement.

For over two hundred years, America's Postal Inspectors have had the responsibility for protecting postal employees, the mails, and postal facilities from criminal attack. Equally important, Postal Inspectors are also entrusted to protect consumers and businesses from being victimized by fraudulent schemes or other crimes involving the mails. As the law enforcement arm of the Postal Service, we work to rid the mails of drug trafficking, money laundering, and mail bombs; and are regarded as a world leader in the fight against one of the most despicable crimes – child pornography.

Today there are approximately 1,900 postal inspectors, 1,400 postal police officers, and 900 professional, technical and support employees of the Postal

Inspection Service. Our agency has the primary responsibility of enforcing roughly 200 federal statutes designed to protect the postal communications system of our nation, and preserve the public's trust and confidence in the U.S. Mail. The Mail Fraud Statute is the oldest and most effective of the consumer protection laws, and the Postal Inspection Service has successfully used it for over 100 years. Of the more than 1,900 Postal Inspectors across the nation, approximately 300 are assigned to mail fraud investigations.

During Fiscal Year 2001, Postal Inspectors conducted 3,475 fraud investigations, and Inspection Service analysts responded to approximately 66,000 mail fraud complaints. By year's end, Postal Inspectors had arrested 1,691 mail fraud offenders, and 1,477 were convicted as a result.

To achieve our goal of ensuring customers' confidence in the mail, the Postal Inspection Service works cooperatively with other law enforcement and consumer groups to educate the public about fraud involving the mail. To increase our efficiency in investigating suspected mail fraud, Postal Inspectors lead and participate in several joint law enforcement and consumer group initiatives aimed at safeguarding the public's confidence in the U.S. Mail.

My assignment includes determining investigative priorities, based on complaints from postal customers, members of the business community, and referrals from other law enforcement and consumer organizations. Mail fraud investigations

are often broad in scope, and typically involve members of the American public as the victims. One such fraud I have become very involved with is viatical settlement fraud.

Viatical Settlement Defined

A viatical settlement is defined as the discounted, pre-death sale of an existing life insurance policy on the life of a person known to have a terminal condition. Viatical settlements started to become popular in the 1980s.

The parties to a viatical settlement may include the insured party, insurance agent/broker, insurance company, viatical settlement company, viatical broker and an investor(s). For example, in a legitimate viatical transaction, an individual purchases a life insurance policy from an insurance company through an insurance agent. After issuance of the policy, the insured party acquires a terminal illness. The insured party then, either through an insurance agent/broker, viatical broker or directly, enters into a contract with a viatical settlement company. The viatical settlement company buys the policy from the insured party and pays the insured party a percentage of the face value of the policy. The viatical company finds an investor(s) who pays a percentage of the value of the policy to acquire the beneficiary rights of the policy. When the insured party succumbs to the illness, the investor receives the insurance benefits in full, as provided by the terms of the policy.

Viatical Settlement Fraud

The victims of viatical settlement fraud include the public, who are investors, and the insurance industry.

Viatical settlement fraud occurs when misrepresentations are made on the insurance policy applications, in effect, hiding the fact that the party applying for a policy has already been diagnosed with a terminal condition, a practice known as "clean sheeting". The type of policy usually affected is known as a "jet issue" policy; a policy not requiring blood work or a physical examination to obtain. These policies generally do not exceed $100,000.

The investor becomes a victim of fraud when misrepresentations are made by the viatical settlement companies about life expectancies of insured parties and guaranteed rates of return.

The elements of the fraud often include a combination of the following:

- Submission of life insurance applications with material
- Misrepresentations (clean sheeting)
- Obtaining multiple policies with various carriers
- Conspiracy between insured party and insurance agent

- Conspiracy between insurance agent and viatical company
- Conspiracy between insured party and viatical company
- Misrepresentations to investors by viatical companies

U.S. Postal Inspection Service response to Viatical Settlement Fraud

In May of 1999, members of the Postal Inspection Service's, Indianapolis Field Office, Fraud Team, were made aware of a growing problem of fraud related to viatical settlements. Based upon discussions with the insurance community, law enforcement and state regulatory agencies it became apparent there was a need to address this issue. A working group of eight Postal Inspectors was established. This working group met in Indianapolis on August 3, 1999, to develop a plan for the Inspection Service's Viatical Fraud Initiative.

In August of 1999, the U.S. Postal Inspection Service established a national task force responsible for developing a strategy for the successful identification, investigation, and prosecution of individuals involved in this fraud. The task force worked from the Indianapolis Field Office and was named Operation "Clean Sheet" (OCS). In November of 1999, the task force became a joint investigative effort with the FBI, and also worked closely with other state law enforcement and regulatory agencies.

Through analysis of the intelligence gathered, the OCS Task Force was able to identify many of the major offenders and assist law enforcement in identifying targets. The OCS Task Force was responsible for initiating, coordinating, and supporting these field investigations.

On May 19, 2000, eight simultaneous search warrants were executed at various locations throughout the United States. Each search warrant was the result of investigations relative to viatical settlement fraud. This effort involved more than 200 federal, state, and local law enforcement officers.

The OCS task force was very successful in forging a cooperative effort among regulatory agencies and state and federal law enforcement nationwide. There are approximately 40 known investigations nationwide. To date, there have been approximately 100 arrests and 75 convictions made relative to viatical settlement fraud. The majority of these investigations are still ongoing.

The Liberte Capital Group investigation in Ohio is a good example of the cooperative effort among state and federal agencies. Agencies participating in this investigation include the U.S. Postal Inspection Service, Ohio Department of Insurance, Federal Bureau of Investigation, Internal Revenue Service and the Department of Justice. On January 18, 2002, seventeen persons associated with the Liberte Capitol Group were indicted on 160 counts of conspiracy to commit mail fraud regarding viatical settlements. Liberte specialized in viatical

settlements, in which investors buy the rights to collect future insurance death benefits of senior citizens and people with fatal illnesses. The indictment alleges that nearly 3000 investors were defrauded of over $100 million as a result of the scheme. Due to the ongoing nature of this investigation, I must refrain from sharing additional particulars with regard to the status of the Liberte matter.

Due to the complexity of this fraud, a single case often involves an insured party, insurance agent, insurance company, viatical settlement company, viatical broker and investors all living in different parts of the country. Therefore, various state and federal jurisdictional boundaries are affected by these investigations. Due to this dispersion, coordination with the Department of Justice and state prosecutorial authorities has been very instrumental in the successful prosecution of these cases.

Victims - Viatical Settlement Fraud

As stated earlier, the victims of viatical settlement fraud include members of the public, typically investors, and the insurance industry.

I. Public

As with most fraud schemes, senior citizens are often targeted by fraudsters and unfortunately end up as victims. Viatical settlement fraud is particularly insidious, as it frequently entices its victims into investing their life savings.

I believe there are several reasons why so many investors have become victims of this fraud. The life insurance industry is one of the oldest and most trusted industries in our nation. For generations, people have trusted in life insurance and faithfully paid their premiums, only to receive what was due upon the death of the insured. Most investors recognize the risk associated with speculative investments. However, when you discuss life insurance most people think of it as a safe secure investment. The distinction between the insurance industry and the viatical settlement industry may not be fully appreciated or understood by most investors.

The investment in viatical settlements also appeals to the humanitarian side of the investor. They perceive themselves as helping a terminally ill person pay for the medical attention needed and to live as comfortably as possible in their final days.

Finally, because of the nature of the fraud, and the obvious need to keep information about the insured private, there is reluctance by investors to follow-up or ask a lot of questions about their investment. When the investment does not

pay off due to the death of the insured, they are most often reluctant to complain because in effect they are complaining that the insured did not die as projected.

II. Insurance Industry

The insurance companies are the other victims of this fraud. Insurance companies become victims when individuals, often conspiring with insurance agents or brokers, fill out insurance applications which contain false statements. These false statements typically hide information about the insured's medical history, which if otherwise known, would prevent insurance companies from issuing policies. Once these policies are in force for a twenty-four month period, they cannot be rescinded, even if fraud is discovered.

Fraud Prevention

The prevention efforts of the task force focused primarily on identification and investigation, and also included outreach to consumer protection groups, the insurance and business community, and oversight and regulatory agencies. Although our efforts have had a significant impact in reducing the fraud in this industry, the Postal Inspection Service emphasizes the importance of consumer awareness and prevention as the best protection for consumers.

States have taken different approaches to regulation; some have regulated through the Department of Insurance and others through the State Securities Departments. The National Association of Insurance Commissioners has developed a model Viatical Settlement Law that has been adopted in whole or in part by many states. To date, much legislation has focused on protecting the viator and/or regulating the viatical companies, and has not focused on protecting investors.

There are many challenges facing law enforcement, regulatory agencies, and the insurance companies as they continue to combat and prevent fraud from occurring in the viatical settlement industry. In working as a task force leader, I have had the opportunity to talk with many individuals from the insurance industry, state regulatory agencies, prosecutors and law enforcement. There are certain concerns/issues that surface during each conversation. These issues are as follows:

Life Expectancy Projections – Life expectancy projections are a key component in determining the pricing and selling of viaticated policies. However, some common unregulated practices within the industry make this type of insurance ripe for fraudulent activity. For instance, in many cases, those performing the projections are employees of the viatical companies, where there exists a strong incentive to project the most aggressive mortality rates possible. Additionally, the lack of uniformity among medical evaluations offers increased opportunities for

fraud. These projections are seldom questioned, thus making them highly susceptible to fraud.

Life Settlements – Our investigations to date have focused primarily on the "Clean Sheeting" and Ponzi scheme type related frauds in the viatical settlement industry. The life expectancies for the insured person on these policies are usually three years or less. However, many industry experts believe the viatical companies are now moving towards a new type of viaticated policies known as life settlements. In these settlements the viator is typically made up of the affluent or elderly investor. The life expectancy for these insureds may be five or more years. Many believe this market will see extraordinary growth, and in the absence of uniform regulations, these settlements have the same potential for fraud.

Insurable Interest – The emergence of the viatical settlement industry has raised the question of the definition of insurable interest. Some question whether policies purchased for the sole purpose of selling to an investor violate the insurable interest principal which requires a close personal relationship or substantial economic interest in the person being insured. With the growth of viatical settlements, the number of people who benefit from the death of insureds will increase. The future impact of this is presently unknown, but of some concern to the law enforcement and the insurance industry.

So, as you can see there are a number of issues that need to be addressed to ensure protection for all parties involved in a viatical transaction. Also, legislative proposals such as H.R. 1408, *Financial Services Antifraud Network Act of 2001,* should be helpful to the law enforcement community, if enacted. The Inspection Service fully supports this legislation and believes it will be of great assistance based on its ability to facilitate information sharing and the leveraging of resources among local, state and federal law enforcement agencies. If this bill becomes law, it will no doubt go a long way in fighting viatical settlement fraud.

Thank you for bringing this important issue to the forefront and taking swift action to protect the American public.

Madam Chairwoman and Members of the Subcommittee, this concludes my remarks, and I would be glad to answer any questions at this time.

Testimony of Lee Covington
Director of Insurance
State of Ohio

Before the
Subcommittee on Oversight and Investigations
Committee on Financial Services
U.S. House of Representatives

Viatical Fraud and
The Financial Services Antifraud Network Act of 2001

February 26, 2002

**Testimony of**
**Lee Covington, Director, Ohio Department of Insurance**
**Before the U.S. House of Representatives**
**Committee on Financial Services**
**Subcommittee on Oversight and Investigations**
**February 26, 2002**

Madam Chair and Members of the Committee –

My name is Lee Covington and I am the Director of the Ohio Department of Insurance. Thank you for the opportunity to be here today to address the problem of viatical fraud and the steps I have taken to combat this type of insurance fraud. I commend the Chair and the committee for its interest in this important issue. I also want to thank this committee and the House of Representatives for its favorable action on Chairman Oxley's H.R. 1408, Financial Services Antifraud Network Act of 2001, and discuss with you how this legislation will enhance the ability of states to currently identify and fight all types of insurance fraud.

During today's testimony, I will discuss:

1. How viatical and life settlement transactions operate and how these transactions can help some of our most vulnerable citizens—terminally ill individuals and senior citizens.

2. The insidious nature of viatical fraud, including how a fraudulent scheme is perpetrated;

3. The steps taken in Ohio and across the country to combat this type of fraud through vigorous criminal investigation and prosecution;

4. Legislative action taken in Ohio and across the country to eliminate or significantly reduce this type of fraud; and

5. The critical need for the Senate to pass Chairman Oxley's H.R. 1408 to provide the states and the federal government the additional tools necessary to fight all types of insurance fraud.

**Viatical and Life Settlement Transactions—The Sale of Life Insurance Policies by Terminally Ill Individuals and Senior Citizens**

Viatical and life settlement transactions enable terminally ill individuals and senior citizens with a limited expected life span to receive a portion of their life insurance benefits prior to death. The word "viatical" is derived from the Latin word "viaticum," which described the payment or provisions given to Roman soldiers before going to war. In a viatical settlement, a viator, who most often is a terminally ill person, or as we are now seeing, a healthy senior citizen, receives a portion of the face value of a life insurance policy in a lump sum prior to death. In this transaction, the viatical settlement provider pays the viator a discounted amount for the life insurance policy, and the viator transfers ownership of the life insurance policy to the viatical settlement provider or related entity, who becomes the named beneficiary under the policy. After the sale between the viator and viatical settlement provider, the viatical settlement provider sells the life insurance policy to investors who provide the funds that the viatical settlement provider pays to the viator. The transfer of funds is conducted through an escrow agent who will provide the documents to the provider and, as soon as the ownership of the policy changes, the escrow agent will send the money to the viator. In most cases, ownership of the life insurance policy or security is held by a business entity that, in turn, will sell interest in the policy to the investors. In sum, the terminally ill person or senior citizen is paid a reduced amount in exchange for the selling of the policy and the viatical settlement provider then has the right to recover the full amount of the life policy upon the viator's death.

While the nature of viatical transactions is dependent on the death of the viator, the social benefit of viaticals are extremely valuable for some terminally ill persons and senior citizens. The money obtained through the sale of viated insurance policies can be used for anything -- from experimental medical treatments not covered by insurance to paying off accumulated bills. Therefore, the social benefit may be very important for some of these individuals. Unfortunately, fraud jeopardizes the very existence of this industry.

**Ohio Viatical Fraud Investigation—Largest in History**

State and federal regulators and prosecutors know that fraud can occur in the procurement and transfer of the ownership of life insurance policies and that has been verified by our recent investigation of an Ohio viatical company. According to a Florida grand jury investigation, as many as half of all life insurance polices involved in viatical transactions may have been obtained with fraudulent intent.

In the largest insurance fraud investigation ever undertaken in the history of the Ohio Department of Insurance, we uncovered a scheme that defrauded victims of more than $100 million. Our investigation, which was a joint effort of the Ohio Department of Insurance and several federal agencies, resulted in the indictment of 15 individuals who fraudulently obtained multiple life insurance policies and an indictment of the owner of Liberte Capital Group, a Toledo-area viatical settlement company. Before providing the details of this investigation, I

want to give special recognition to United States Attorney, Emily Sweeney and Assistant United States Attorney, Seth D. Uram, the Federal Bureau of Investigation, the Internal Revenue Service, and the United States Postal Inspection Service, and several other states' insurance departments for their work and partnership in this effort.

The Ohio Department of Insurance opened its investigation in the summer of 1999 after receiving a tip from an insurance company. When our investigators began looking into this case, we discovered that the alleged fraudulent activity was occurring in several states. Because of the multi-jurisdictional nature of the investigation, we contacted the federal agencies and we combined our resources to investigate the case. The combination of state and federal resources has enabled us to identify, investigate and indict individuals who conspired to defraud nearly 3,000 investors of more than $100 million.

The Department of Insurance investigation focused on 32 viators who are accused of fraudulently obtaining at least five (5) life insurance policies each and collectively obtaining approximately 200 policies and selling them to Liberte Capital Group. Viators fraudulently obtain insurance policies by:

- Cleansheeting – The fraud occurs when applicants lie on an application about their bad health condition in order to purchase a life insurance policy. Insurers generally will not issue a life insurance policy to someone with a terminal illness.
- Imposter Fraud – An individual will pose as another person who is applying for an insurance policy. The imposter may take blood tests and/or physicals for the insured, which often misleads an insurance company into believing the applicant is in good health.

Because of this investigation, 85 insurance companies were able to rescind most of the fraudulent policies, saving the companies more than $25 million. This type of fraud against insurance companies and investors can severely damage the financial solvency of an insurance company and wipe out all the assets of an investor. The victims of this fraud are not just insurance companies and their legitimate customers who end up paying more in higher premiums, but also consumers who stand to lose their investment when policies are cancelled or lapse.

Viatical fraud is complex and it is challenging to uncover this type of fraud. Ohio Department of Insurance fraud investigators discovered and reviewed three storage rooms full of evidence, conducted hundreds of interviews, and organized thousands of documents that were presented to the grand jury that handed up the indictments. The Department investigator assigned to this case devoted more than 4,000 hours to the effort during the past three years.

**Ohio Anti-Fraud Legislation**

In addition to our aggressive anti-fraud criminal investigation efforts, the Ohio Department of Insurance has been active on the legislative front as well, developing and working on a new law, sponsored by state Representative Amy Salerno (R-Columbus), to prevent this kind of fraud. In January of 2001, Governor Bob Taft signed into law legislation providing for the

specific licensing and increased regulation of viatical settlement providers and brokers. This legislation was strongly supported by the Ohio Department of Insurance and the Ohio Department of Commerce. House Bill 551 was based on a model developed and adopted by the National Association of Insurance Commissioners in March 2001, and I am proud to report that Ohio was the first state to adopt this model.

The new law:

- Includes a clear definition of fraudulent viatical settlement acts and provides administrative and criminal penalties for violations which gives the Department the authority to request an injunction ordering a viatical settlement provider, broker or person to immediately stop potentially harmful activities during an investigation, which can prevent or limit the scope of damages and the number of victims.

- Prohibits brokers and providers from entering a viatical settlement contract within two (2) years of issuing a life insurance policy unless they meet one of these four (4) legitimate exceptions:
    - The viator or insured is terminally or chronically ill;
    - The viator's spouse dies
    - The viator divorces their spouse;
    - The viator becomes physically or mentally disabled and a physician determines that the disability prevents the viator from maintaining full-time employment.

  This keeps viators from fraudulently obtaining and immediately viatizing insurance policies – what are known in the industry as "wet viaticals," because viators complete the fraudulent viatical transaction before the ink is even dry from their signing of the fraudulent application.

- Requires a notice be sent to the insurer within 20 days of an agreement to viaticate a policy. This alerts an insurance company that they may want to examine the policy for potential fraud. If the insurer can prove the policy was obtained fraudulently, it can rescind the policy.

- Requires viatical settlement providers and brokers to obtain a license from the Department of Insurance in order to engage in the sale of viatical settlements. This law subjects brokers and providers to the oversight and regulation of the Department. Previously, there was no oversight or regulation of this industry in Ohio.

- Clarifies that viatical settlement transactions are "securities" under Ohio law and subject to all regulation associated with securities.

This law gives the Department of Insurance and the Ohio Department of Commerce the ability to protect Ohio consumers.

The new law enables us to aggressively combat viatical fraud. Without the work of the state and federal agencies involved in this investigation, many more investors and companies could have been hurt by this scheme. I am confident that the actions of law enforcement agencies involved in this case will serve as a deterrent to this type of crime in the future. I also believe that

the viatical anti-fraud laws adopted last year in the state of Ohio will aid these agencies in the regulation of the viatical industry.

**Actions by Other States**

Although I have focused on Ohio's activities and accomplishments, I know this issue is a high priority for other states. This industry is rapidly evolving, and constant monitoring of the changes in the industry has been a priority for the states.

At least 12 other states have or have pending regulations to update their laws by adopting the NAIC model, which was finalized in March 2001. A majority of the states (29) have similar laws and are expected to determine if they need to revise their current laws to provide additional protections against viatical fraud.

In terms of protecting consumers, state insurance regulators have been responsive to the need to regulate the viatical industry and provide a safety net to ensure that viatical fraud is detected and eliminated. Key components of these state laws are licensure, disclosure, and notice of these transactions. The majority of states have these requirements for those individuals that engage in viatical settlement transactions.

The NAIC acted previously to protect the terminally ill through Model Laws adopted in 1993 and 1998. These models focused on consumer protections aimed at ensuring that the terminally ill were provided disclosures regarding alternatives to viatical settlements, tax implications, and other important consumer rights. Unfortunately, until 1999, no one ever anticipated these transactions would be adulterated by the acts of criminals ready to perpetrate fraud.

Based on the information I have received, it appears that the insurance industry first became aware of this type of fraud at some point in 1999. Based on our research, John Hancock Life Insurance Company was the first insurance company to take action to rescind fraudulently obtained policies when it filed a court action in Florida in late 1999. Therefore, in a little over a year after the very first actions on this type of fraud, the NAIC updated and adopted a Model to address this type of viatical fraud.

**Need for H.R. 1408, Financial Services Antifraud Network Bill**

Congress can help state regulators in our efforts to combat insurance fraud, and the House of Representatives has already done so by passing Chairman Mike Oxley's legislation, H.R. 1408, Financial Services Antifraud Network Act of 2001. This bill is a giant step forward, and I strongly support immediate action by the United States Senate to pass this legislation.

This legislation will be extremely beneficial to state regulators because it provides state regulators access to an existing network of criminal and administrative databases, including the Federal Bureau of Investigation's antifraud database. According to the Coalition Against Insurance Fraud, insurance fraud costs American families almost $1,000 per year. It is tax imposed on each American by criminals.

While much of our success in the recent viatical fraud investigation was attributable to our close working relationship with federal agencies, Chairman Oxley's bill will formalize these interactions and encourage comprehensive cross-regulatory coordination to detect fraud and

provide comprehensive guidelines for safeguards to protect the confidentiality, privacy, and security of shared information.

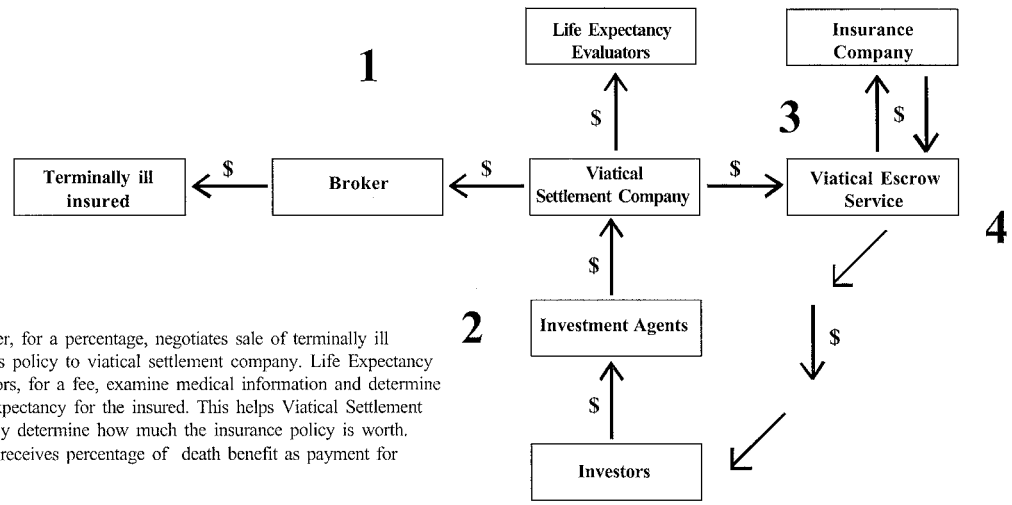
Ohio has also taken steps to ensure the clarity of our statutory authority to share non-public records regarding fraud investigations. Senate Bill 138, our information sharing legislation, was part of the NAIC's effort to ensure that all states have the ability to enter into and participate in information sharing agreements among state and federal functional regulators and law enforcement agencies.

**Conclusion**

In conclusion, Ohio and other states have put the viatical industry on notice – if they are going to do business in our states, they must comply with all our requirements or we will take aggressive action. I am pleased that our investigation was successful and know that on-going efforts to eliminate this fraud will yield positive results. We recognize this industry is changing quickly. State regulators are on the front lines of ensuring that existing laws are sufficient and that regulators can quickly respond to address any new developments that may emerge.

I again appreciate this opportunity to testify before the committee on viatical fraud. I thank you for your effort to combat fraud across all financial services industries, and I urge the Senate to act quickly to pass H.R. 1408, to provide regulators additional tools to fight fraud. I would be happy to answer any questions.

# How a Viatical Settlement Agreement is supposed to work




1. Broker, for a percentage, negotiates sale of terminally ill insured's policy to viatical settlement company. Life Expectancy Evaluators, for a fee, examine medical information and determine a life expectancy for the insured. This helps Viatical Settlement Company determine how much the insurance policy is worth. Insured receives percentage of death benefit as payment for policy.

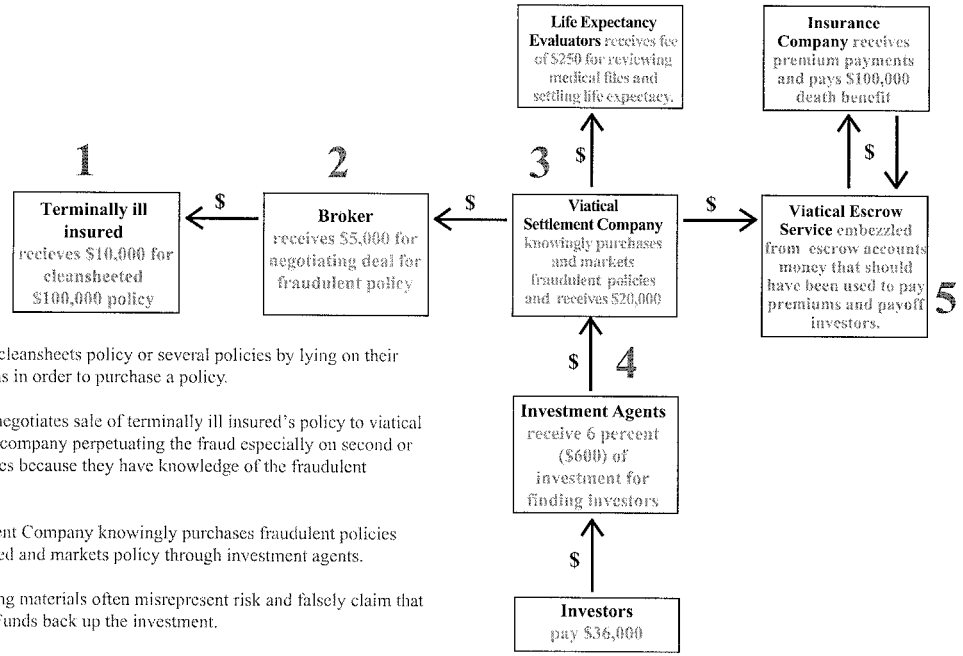
2. Settlement company investment agents sell policies to investors for a percentage. They use marketing materials provided by Viatical Settlement Company.

3. Viatical escrow service holds investor money and pays premiums to insurance company.

4. When insured dies, insurance company pays death benefit to viatical escrow services who pays the investors.

# Where Viatical Fraud Occurs

## Follow the Money ($100,000 policy)




1. Insured cleansheets policy or several policies by lying on their applications in order to purchase a policy.

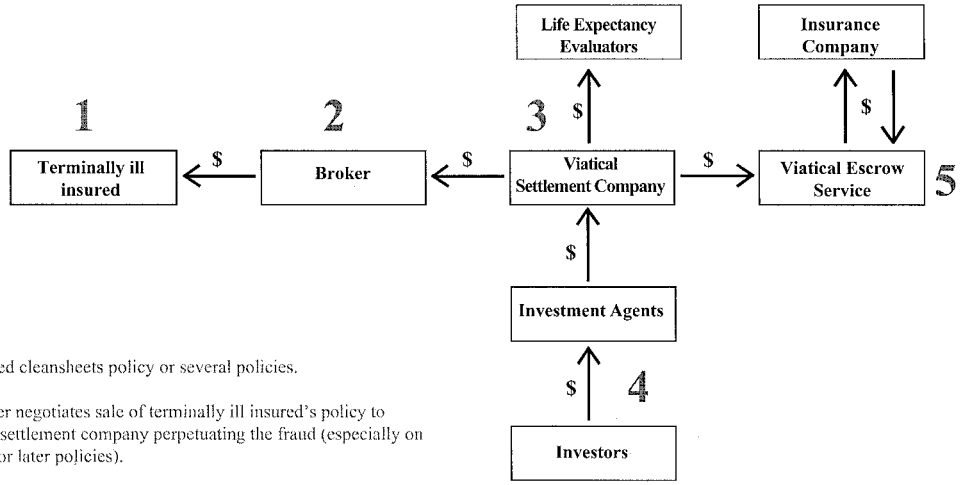
2. Broker negotiates sale of terminally ill insured's policy to viatical settlement company perpetuating the fraud especially on second or later policies because they have knowledge of the fraudulent policies.

3. Settlement Company knowingly purchases fraudulent policies from insured and markets policy through investment agents.

4. Marketing materials often misrepresent risk and falsely claim that Guaranty Funds back up the investment.

5. Viatical escrow service embezzles money from escrow accounts. When insured dies, viatical escrow service has no money to pay investors.

# Where Viatical Fraud Occurs




1. Insured cleansheets policy or several policies.

2. Broker negotiates sale of terminally ill insured's policy to viatical settlement company perpetuating the fraud (especially on second or later policies).

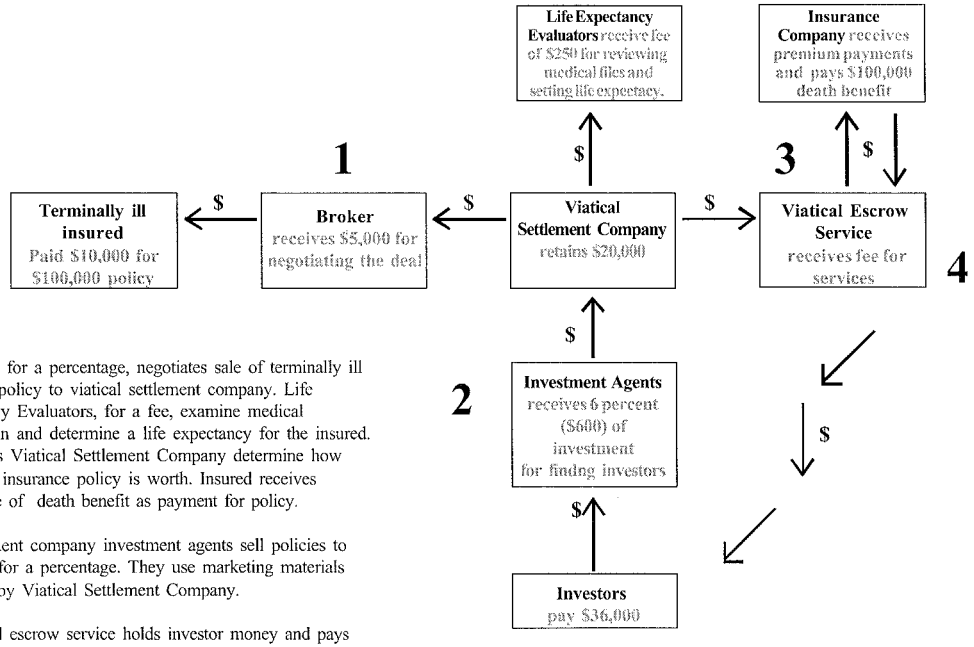
3. Settlement Company knowingly purchases fraudulent policies from insured and markets policy through investment agents.

4. Marketing materials often misrepresent risk and falsely claim that Guaranty Funds back up the investment.

5. Viatical escrow service embezzles money from escrow accounts. When insured dies, viatical escrow service has no money to pay investors.

# How a Viatical Settlement Agreement is supposed to work

## Follow the Money ($100,000 policy)




1. Broker, for a percentage, negotiates sale of terminally ill insured's policy to viatical settlement company. Life Expectancy Evaluators, for a fee, examine medical information and determine a life expectancy for the insured. This helps Viatical Settlement Company determine how much the insurance policy is worth. Insured receives percentage of death benefit as payment for policy.

2. Settlement company investment agents sell policies to investors for a percentage. They use marketing materials provided by Viatical Settlement Company.

3. Viatical escrow service holds investor money and pays premiums to insurance company.

4. When insured dies, insurance company pays death benefit to viatical escrow services who pays the investors.

Investor money goes to pay premiums, broker's percentage, escrow services, life expectancy evaluation, and terminally ill insured.

**Ohio Department of Commerce**
77 South High Street • 23rd Floor
Columbus, OH 43215-6123
(614) 466-3636 FAX (614) 644-8292
www.com.state.oh.us

Bob Taft
Governor

Gary C. Suhadolnik
Director

**Testimony of**
**THOMAS E. GEYER**
**ASSISTANT DIRECTOR, OHIO DEPARTMENT OF COMMERCE**

**Regarding**
**VIATICAL SETTLEMENT TRANSACTIONS**

**Before the**
**UNITED STATES HOUSE OF REPRESENTATIVES**
**COMMITTEE ON FINANCIAL SERVICES**
**SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS**

**February 26, 2002**

Madam Chairwoman and members of the Subcommittee, my name is Tom Geyer, and I am an Assistant Director of the Ohio Department of Commerce. From 1996 to 2000, I served as Commissioner of the Ohio Division of Securities, and was responsible for administering and enforcing the Ohio securities laws. I also serve as an adjunct professor, teaching securities law, at the Capital University Law School.

I thank you for the privilege of appearing before you today, and commend you for hearing testimony regarding viatical settlement transactions. This is a timely discussion of an industry that one commentator has suggested amounted to $4 billion in 2000.[1] Another commentator has described the industry as "infected with scam artists, ponzi schemes, and other fraudulent activities."[2]

While Securities Commissioner, I witnessed first-hand the use, and abuse, of viaticals. As a result of that experience, my testimony today will address five areas: an overview of viatical settlement transactions; an explanation of the securities law aspects of viatical settlement transactions; a description of our experience with fraud and enforcement regarding viatical settlement transactions in Ohio; a brief discussion of the experiences of other state securities regulators; and a discussion of the recent Ohio legislation that established comprehensive oversight of viatical settlement transactions in the Buckeye State.

*Overview of Viatical Settlement Transactions*

The word "viatical" is derived from the Latin word "viaticum," which described the payment or provisions given to travelers or soldiers before embarking on a journey. In general, a "viatical settlement transaction" is an arrangement pursuant to which a person or company, usually known as a "viatical settlement provider," pays to the terminally ill owner of a life insurance policy, usually known as the "viator," compensation or value less than the death benefit of the policy in return for the viator's assignment of the right to receive the death benefit. Sometimes, there is a

third party involved in the transaction, a "viatical settlement broker," who for a fee or commission introduces a viator to a viatical settlement provider and/or negotiates viatical settlement arrangements.

A similar type of transaction is known as a "life settlement transaction," which is the same as a viatical settlement except that the insured is not terminally ill. In other words, a healthy (albeit usually senior) owner of a life insurance policy is paid compensation or value less than the death benefit of the policy in return for his or her assignment of the right to receive the death benefit. (For ease of discussion, as used in this testimony, the phrase "viatical settlement transaction" includes "life settlement transaction.")

In most cases, the viatical settlement providers raise money from investors in order to fund the pay-out to the insured. In return for providing funds, investors receive the death benefit (or a proportionate share thereof) upon the passing of the insured. This benefit is designed to be more than the original investment, creating a "return on investment."

A simple example of a viatical settlement transaction is as follows: assume that a terminally ill person holds a life insurance policy with a death benefit of $100,000. A viatical settlement provider offers to pay that person $80,000 for the right to receive the death benefit. To fund the $80,000 pay-out, the provider raises $9,000 each from 10 investors. Of the $90,00 raised, the provider pays $80,000 to the insured and keeps $10,000 for administrative costs and profit. Upon the passing of the insured, each of the 10 investors receives $10,000, for a $1,000 return on their original $9,000 investment.

*Securities Law Aspects*

A viatical settlement transaction is a hybrid transaction that implicates both insurance law and securities law. The insurance law component of the transaction arises when the viatical settlement provider transacts with the insured, and also may involve the acquisition of a life insurance policy by the insured. Director Covington will discuss the insurance law aspects of viatical settlement transactions.

The securities law component of a viatical settlement transaction arises when a viatical settlement provider solicits investors to raise money to fund the pay-out to the insured. Investors are induced to invest with the promise that they will receive a death benefit (or fraction thereof) in an amount that will exceed their original investment. This type of arrangement constitutes an "investment contract," which is a type of security. In general, an investment contract is created when: (1) an investor provides initial value; (2) a portion of the initial value is subjected to the risks of the enterprise; (3) the furnishing of initial value is induced by the promise of the return of a valuable benefit over and above the initial value; and (4) the investor has no managerial control over the enterprise.[3]

Once a transaction constitutes a "security," the securities laws impose three basic requirements: first, all persons that sell securities must be licensed or properly excepted from licensure; second, all securities products must be registered or properly exempted from registration; and third, there must be full and fair disclosure of all material terms and conditions of the transaction. This

three-part framework of oversight provides essential investor protections by ensuring that those who sell securities have some minimum level of competency to engage in the business, by requiring full disclosure, and by prohibiting misstatements, omissions and fraud. Further, the securities regulatory framework provides that investors victimized by securities law violations have the right to rescind the transaction, or in some cases, sue for damages. Investors in viatical settlement transactions, like investors in any other security, have the right to these protections.

*The Ohio Experience with Fraud and Enforcement*

However, in many cases, investors in viatical settlement transactions have been denied these basic rights because viaticals have proven to be fertile ground for fraud and other violations of the securities laws.

In Ohio, we initiated our first enforcement action in June 1998. Since that time, we have initiated 30 enforcement actions regarding viatical settlement transactions, 26 of which have resulted in final orders to cease and desist from violating the Ohio Securities Act (the other 4 are pending). All of our final orders have found the failure to properly register or exempt the viatical settlement transactions under Ohio law, meaning there was no assurance of compliance with the laws requiring full and fair disclosure. Over half have involved the sale by unlicensed persons, meaning that there was no assurance that the seller had any level of competency regarding investment and financial issues. And nearly one in five have involved the misstatement or omission of material facts.

A common misstatement is a misrepresentation regarding the riskiness of an investment in a viatical settlement transaction. Often marketed as a "safe" or "guaranteed" investment because of the certainty of death,[4] the return on a viatical investment results from the timing of the passing of the insured, which is extremely uncertain. The longer the insured lives, the lower the value of the return to the investor. And since an investment in a viatical settlement transaction is illiquid (meaning that there is no "secondary" marketplace where viatical investments can be bought and sold after the original investment) the investor's fortunes lay solely with the health of the insured.

Common omissions include: the failure to advise investors that they may be liable to pay premiums to keep the insurance policy in force;[5] the failure to advise the investor that the policy may be contestable; the failure to disclose commissions or administrative fees; and the failure to provide information about the background or financial wherewithal of the viatical settlement provider and its principals.[6]

An investor also may be victimized when the underlying insurance policy is fraudulently obtained, and the insurance company refuses to pay the claim.[7]

One of our first investigations regarding viaticals involved Toledo, Ohio, based Liberte Capital Corporation. This company and its principals are the subject of a 160 count criminal indictment handed down last month in the federal district court for the Northern District of Ohio.[8] We began an investigation into securities law violations in the spring of 1998 by gathering information from investors, subpoenaing and analyzing bank records, and conducting

investigatory interviews with a number of individuals, including the two main figures in the probe, J. Richard Jamieson and James Capwill. In 1999, we took formal administrative action based on the sale of unregistered securities. At the beginning of 2000, we coordinated our efforts with the FBI and the IRS. By that time, a federal grand jury had been convened to investigate criminal conduct, and with the help of the Ohio Department of Insurance the probe soon uncovered fraudulent activities on the insurance side of the Liberte viatical settlement transactions. The indictment alleges that viators fraudulently obtained life insurance policies, and then sold the rights to the death benefits to Liberte. Allegedly, Liberte knew of this fraud, but nonetheless fraudulently induced investors to provide funds for the pay-out to the viator. The scheme began to unravel when insurers began to cancel the fraudulently acquired policies. Authorities estimate that nearly 3,000 investors nationwide were defrauded out of over $100 million between 1996 and 2000.

*The Experience of Other State Securities Administrators*

Our experience with securities law violations in Ohio is not unique; in May 1999, the North American Securities Administrators Association ("NASAA") identified viatical settlement transactions as one of the country's top ten financial scams. The experiences of other state securities administrators could be the subject of its own testimony.

Although in some jurisdictions state insurance authorities have sole authority over viatical settlement transactions, in the states where securities and insurance regulators share oversight, securities regulators uniformly have stated that viatical settlement transactions constitute "securities" under state securities law. Many states have vigorously pursued enforcement actions.

In Texas alone, state authorities have obtained criminal convictions in three separate multi-million dollar viatical cases since 2000.[9]

In Florida, federal authorities obtained a 42 count conviction in August 2000 in a case where the promise of a 42% return on viatical investments induced over 3,000 investors to invest over $100 million, and only $6 million was used to purchase insurance policies.[10]

All tolled, NASAA recently estimated that, over the last three years its members have brought enforcement actions in viatical cases involving approximately $300 million.

*Ohio's Legislative Response to Viatical Settlement Transactions*

As we grappled with the lack of securities law compliance in 1998 and 1999, we learned that the Ohio Department of Insurance also had serious concerns about viatical settlement transactions. We began a series of meetings with the Insurance Department, and the discussions soon focused a comprehensive legislative remedy to the viaticals problem. These discussions culminated with State Representative Amy Salerno's introduction of House Bill 551 into the 123rd Ohio General Assembly in January 2000. Supported by both the Division of Securities and the Department of Insurance, the measure moved through the legislature and was signed into law by Governor Bob Taft in January 2001. To my knowledge, H.B. 551 is the first single "comprehensive" bill that

addresses both the state securities law and state insurance law components of viatical settlement transactions, and represents a wonderful level of cooperation between two state agencies. It is my understanding that other states are pursuing similar "comprehensive" measures.

H.B. 551 establishes consumer safeguards while at the same time setting reasonable regulatory standards for the legitimate participants in the viaticals industry. Further, the bill created no new bureaucracy since existing agencies absorbed the new laws as part of their normal regulatory obligations.

On the insurance side, as will be discussed in more detail by Director Covington, the bill establishes a series of protections for the viator, and a system of oversight of viatical settlement providers and brokers.

On the securities side, the bill makes clear that viatical settlement transactions and life settlement transactions are "securities" under Ohio law.[11] As a result: viatical investments must be registered with the Ohio Division of Securities or properly exempted from registration; persons selling viatical investments must be licensed by the Division or properly excepted from licensure; and misstatements and omissions of material facts are prohibited. The applicability of the securities laws creates a credible marketplace in which legitimate companies can raise money for viatical pay-outs, and viatical investors can receive full disclosure and expect a fair return on their investment.

*Conclusion*

Whether you believe that viatical settlement transactions are socially valuable tools that provide funds to the terminally ill, or you believe that they are abhorrent investment products because they derive their return from death, the fact of the matter is that viatical settlement transactions are here, and appear to be here to stay. In light of this, meaningful regulation is essential to ensure that neither viators nor investors are defrauded. As demonstrated in Ohio, this presents an opportunity for state securities and insurance regulators to work together to establish functional regulation in this area. These regulators, along with legislative bodies, must remain vigilant to ensure that the viaticals marketplace is one characterized by full disclosure, the absence of fraud, fair pay-outs to viators, and fair returns to investors.

*Endnotes*

[1] Jones, *The Viatical Settlement Industry: The Regulatory Scheme and Its Implications for the Future of the Industry*, 6 Conn. Insurance L. J. 477, 483 (2000).

[2] Ray, *The Viatical Settlement Industry: Betting on People's Lives is Certainly No Exacta*, 17 J. Contemp. Health Law & Policy 321, 322 (2000).

[3] *See* State v. George, 50 Ohio App. 2d 297 (10th Dist. Ct. App. 1975). For the enunciation of the similar test for an investment contract under federal law, *see* SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

[4] *See, e.g.,* In the Matter of Paragon Capital Group, Inc., Ohio Division of Securities Order No. 00-453 (Nov. 30, 2000) (Paragon sales literature stated that the investment was "always safe"); In the Matter of Blackstone Financial Services and Joseph E. Devlin, Ohio Division of Securities Order No. 01-017 (Jan. 23, 2001) (Devlin told the investor that "there was no way she could lose her principal investment").

[5] *See, e.g.*, In the Matter of Paragon Capital Group, Inc., Ohio Division of Securities Order No, 00-453 (Nov. 30, 2000) (investors were victimized when premiums were not paid on underlying insurance policies).

[6] *See, e.g.*, In the Matter of Blackstone Financial Services and Joseph E. Devlin, Ohio Division of Securities Order No. 01-017 (Jan. 23, 2001) (investors were victimized when Blackstone and Devlin filed bankruptcy).

[7] *See, e.g.*, United States v. Jamieson, et al, No. 3:02CR707 (N.D. Ohio Jan. 23, 2002). Lying about health conditions in order to obtain a life insurance policy is known as "cleansheeting."

[8] *Id.*

[9] *See, e.g.*, State v. Sharon June Hutchison, Nos. 0818567/0818606 (Dec. 7, 2001 and Jan. 15, 2002), District Court of Tarrant County (defendant convicted on 10 counts of selling securities without a license – including $2 million of fraudulent viatical contracts – and sentenced to 9 years in prison); State v. Michael Lee Davis, Nos. F-99-99980-RL, F-99-99981-RL, F-99-9982-RL, F-99-99983-RL, F-99-99984-RL, and F-99-99985-RL (2000), District Court of Dallas County (defendant sentenced to six 60-year prison terms and ordered to pay $5.6 million in restitution for defrauding scores of elderly investors and more than a dozen insurance companies in a scheme involving viatical settlement agreements); State v. Sherry W. Keisling, Nos. CR-26153 and CR-26154 (2001) District Court of Midland County (defendant pleaded guilty to violating Texas Securities Act in connection with the sales of certificates of viaticated insurance benefits, was ordered to pay restitution and placed on ten years probation).

[10] Frolik, *Insurance Fraud on the Elderly*, Trial Magazine (June 1, 2001); *see also* In re Financial Federated Title & Trust, Inc., 252 B.R. 834 (Bankr. S.D. Fla. 2000).

[11] H.B. 551 added the phrase "life settlement interest" to the definition of "security" in Ohio Revised Code § 1707.01(B). "Life settlement interest" is defined " in Ohio Revised Code § 1707.01(HH), which states:

> "Life settlement interest" means the entire interest or any fractional interest in an insurance policy or certificate of insurance, or in an insurance benefit under such a policy or certificate, that is the subject of a life settlement contract.
>
> For purposes of this division, "life settlement contract" means an agreement for the purchase, sale, assignment, transfer, devise, or bequest of any portion of the death benefit or ownership of any life insurance policy or contract, in return for consideration or any other thing of value that is less than the expected death benefit of the life insurance policy or contract. "Life settlement contract" includes a viatical settlement contract as defined in section 3916.01 of the Revised Code, but does not include any of the following:
>
> (1) A loan by an insurer under the terms of a life insurance policy, including, but not limited to, a loan secured by the cash value of the policy;
>
> (2) An agreement with a bank that takes an assignment of a life insurance policy as collateral for a loan;
>
> (3) The provision of accelerated benefits as defined in section 3915.21 of the Revised Code;
>
> (4) Any agreement between an insurer and a reinsurer;
>
> (5) An agreement by an individual to purchase an existing life insurance policy or contract from the original owner of the policy or contract, if the individual does not enter into more than one life settlement contract per calendar year;
>
> (6) The initial purchase of an insurance policy or certificate of insurance from its owner by a viatical settlement provider, as defined in section 3916.01 of the Revised Code, that is licensed under chapter 3916. of the Revised Code.

WRITTEN STATEMENT

U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES

OVERSIGHT AND INVESTIGATIONS SUBCOMMITTEE
FEBRUARY 26, 2002

Ladies and Gentlemen:

I am John Wayne Lazar, 78 years old and a resident of Clinton Township, Michigan. I was born and raised in the Detroit area. I am a widower and I have two sons and five wonderful grandchildren.

I proudly served my country in the Navy between 1943 and 1945. After my military service, I earned a bachelor's degree in industrial engineering from the Lawrence Institute of Technology. For forty years, I worked in the automotive industry in various engineering and management positions. I retired in 1991 and moved to Florida to enjoy the retirement that I worked so hard for.

In approximately 1997, I began reading about viatical settlements. I read articles in the *Wall Street Journal* and even saw a favorable report on *60 Minutes*. I was quite interested in the use of viatical settlements for my retirement investments. I then contacted a number of viatical companies, obtained written material and reviewed the material in detail. Viatical settlements were marketed as safe, secure, guaranteed and humanitarian investments. I was assured that they were safer than CDs and provided a higher rate of return. Furthermore, I was told that an investment in a viatical settlement would assist individuals with AIDS and other terminal illnesses who were in desperate need of financial help during the last days of their life. I was told that this was a "noble" investment.

After carefully reviewing the investment material, I decided to invest nearly all of my retirement savings consisting of approximately $120,000 in an IRA and $50,000 in other savings. Because of some lingering uncertainty with this type of investment, I elected to invest this money in Liberte Capital for only one year. I was guaranteed a return of 14% paid in quarterly installments. I received three quarterly interest payments and no more. My principal has never been returned. I have moved back to Clinton Township to be close to one of my sons. I presently live on my monthly social security payment and the interest I am earning as a result of the sale of my home in Florida.

Needless to say, my financial situation has been devastated by the fraudulent activities of Liberte Capital. I am the Class Representative in a lawsuit that has been filed to recoup our investments. My lawyers have advised that, at best, we can expect only a small portion of our investments to be returned. As the Class Representative, I have spoken to Liberte Capital investors across the country.

Most Liberte Capital investors are senior citizens who, like me, invested all or a significant portion of their life savings. Many of these investors have had to sell their homes and move into apartments in order to make ends meet. Other investors have had to return to the workforce. Some investors forego the amenities which they planned for and struggle to afford the necessities of daily living such as utilities, food and medical care. I am attaching to this statement a few letters from investors that accurately portray their situations. I could attach hundreds more of such letters. I am also attaching an article that appeared recently in the Toledo, Ohio newspaper, *The Blade* which explains the devastating impact the fraudulent activities of Liberte Capital have had on a small town in Indiana.

I thank you for the opportunity to appear before you today. On behalf of all of the Liberte investors, I request your help in dealing with this devastating situation.

**Founding Members:**
Coventry First, LLC
Life Capital, BV
Life Equity, LLC
Life Settlement Corporation
Living Benefits Financial Services, LLC
Stone Street Financial, Inc.

**Written Statement**
**Of David M. Lewis**
**Representing the Life Settlement Institute**
**Before the**
**U.S. House Of Representatives**
**Committee on Financial Services**
**Oversight and Investigations Subcommittee**
**February 26, 2002**

Good afternoon. My name is David M. Lewis and I am appearing before the subcommittee today in my capacity as President of the Life Settlement Institute. By way of background I have been a practicing attorney for 31 years, including four (4) years as a staff attorney in the Division of Enforcement of the Securities and Exchange Commission ("SEC").

The Life Settlement Institute is a trade association whose members are institutionally funded life settlement providers and financing entities. A primary purpose of the Life Settlement Institute is to encourage regulation of viatical and life settlement transactions. Life Settlement Institute members do not use private investor funds to purchase policies, but instead use financing provided by banks, insurance companies and other institutional sources of capital. As an aside, Life Settlement Institute members have worked with the trustee in the Liberte case to purchase policies from the bankruptcy estate. These funds will be used to cover at least some of the investor losses.

The Life Settlement Institute and its members strongly support strict regulation by state insurance and securities regulators of the viatical and life settlement marketplace.

Viatical and life settlements provide meaningful alternatives to persons facing terminal illnesses, or who have life insurance policies they no longer want or can afford. A life settlement transaction is different from a traditional viatical settlement. In a viatical settlement, the insured has a terminal illness and their life expectancy is normally estimated to be two years or less. The transaction is designed to provide needed funds to assist persons with short life expectancies in improving the quality of their life.

In a life settlement, the insured is a senior citizen who is over the age of 65, does not have a terminal illness and has an estimated life expectancy of up to twelve (12) years. A life settlement gives policyholders a new option to consider in their financial planning. Typically, a person who has a life insurance policy they no longer want or need can do one of two things, 1) stop paying the premium and let the policy lapse or 2) surrender the policy to the issuing insurance company for the cash surrender value. As you may know, a majority of life insurance policies held by persons over the age of 65 merely lapse with no value to the insured. A life settlement allows the senior citizen owner of the policy to obtain more value for their policy than they could receive from the issuing insurance company.

I would like to share with you some examples of the benefits of a life settlement transaction to seniors who have insurance policies that they no longer want or need:

One of our members recently closed on a transaction with a 69-year-old male from Pennsylvania who had a $500,000 term life policy where he could not afford the renewal premiums. He had an estimated life expectancy of approximately seven (7) years. The policy had no cash value. The Life Settlement Institute member was able to pay the senior $100,000 for his policy and the senior used the proceeds to pay for his long-term care needs.

In another recent transaction a member purchased a $750,000 Universal Life policy from a 72-year-old female from New Jersey who had an estimated life expectancy of 6 years. The policy had a cash surrender value of $40,000. The member was able to pay the senior $165,000, and the funds enabled her and her husband to stay in their family home.

These examples, and many others that we could provide, demonstrate the value to seniors of the availability of this new financial option.

At the present time approximately 35 states regulate through their insurance regulators traditional viatical transactions, and, of that group, approximately 13 also regulate life settlements. Only approximately 20 states regulate the sale of viatical or life settlements to private investors. This regulation is through their securities regulators.

Last year the National Association of Insurance Commissioners promulgated its revised Viatical Settlements Model Act (the "Model Act"). The Model Act regulates both traditional viatical settlements and Life Settlements. The Life Settlement Institute and its members have worked closely with the NAIC Viatical Working Group that developed the Model Act. We commend Commissioner Dunlap of Louisiana, the Chair, and the other Working Group members for their diligent efforts.

The alleged fraud resulting in the Liberte Capital Group case and others like it around the country were not caused by anything inherently wrong in a viatical or life settlement transaction, but were caused by persons taking advantage of a regulatory vacuum that allowed them to practice their scheme on an unsuspecting public. If Ohio had the viatical settlement law it now has, we doubt whether the Liberte fraud would have occurred.

There is nothing new about the fraud in the Liberte case: When I was a young lawyer working at the Securities and Exchange Commission in the 1970's the

"Enron" of its day was Equity Funding, a large public company that "cooked its books" by creating phony life insurance polices that it resold to reinsurance companies

We applaud the efforts of Ohio regulators and those elsewhere who are cracking down on fraudulent activities. Increased regulation and the enforcement thereof will minimize, if not eliminate, these abusive activities.

The abuses highlighted by the Liberte case are (1) fraud in the sale of viatical policies to private investors, and (2) fraud with respect to obtaining life insurance policies. The following initiatives would strengthen the regulatory environment and help prevent future cases like Liberte:

**First**, on the Federal level, the amendment of the Federal Securities Act of 1933 so that the packaging and sale of interests in life insurance policies to private investors are deemed to be "securities" under that Act and are regulated by the Securities and Exchange Commission. This legislation is needed to correct the current Federal case law on the subject. The Federal Securities Laws have served the public and the nation's businesses well over the years and there is no reason to believe that they would not work just as well at regulating the sale of viatical or life settlements to private investors.

**Second**, on the state level, we urge the passage in every state of legislation patterned after the NAIC Model Act[1]. The NAIC Model Act provides for strong regulation of the viatical settlement industry to be conducted by the Department of Insurance in each state. Importantly, the NAIC Model Act also includes many provisions that strongly support the use of institutional funds for the purchase of life insurance policies. We believe that the use of institutional funds, with the stringent due diligence requirements that are attendant to its use, is the best way

[1] The Life Settlement Institute does intend to offer or suggest certain amendments to the Model Act as it is introduced around the country. These amendments are largely technical in nature and are designed to correct drafting errors in the Model Act.

to promote an industry that provides a valuable service to seniors and to protect such potentially vulnerable individuals from fraudulent business practices.

Thank you for allowing me to appear before you today. I would be pleased to answer any questions that the sub-committee members have.

**Founding Members:**
Coventry First, LLC
Life Capital, BV
Life Equity, LLC
Life Settlement Corporation
Living Benefits Financial Services, LLC
Stone Street Financial, Inc.

## FACT SHEET

The **Life Settlement Institute** was formed in response to the need to promote public awareness of the benefits of Life Settlements and to present the viewpoint of institutionally funded Life Settlement providers and financing entities to policy owners, state regulators and organizations such as the National Association of Insurance Commissioners.

Life Settlements involve the purchase of life insurance policies from persons generally over the age of 65 who have policies they no longer want or need. These transactions permit the owners of such policies to obtain more than the cash surrender value of the policy.

Members of the **Life Settlement Institute** are committed to strict regulation of the Life Settlement market and to the elimination of inappropriate practices.

Founding members of the **Life Settlement Institute** include:

- Coventry First, LLC; Fort Washington, PA
- Life Capital, BV; San Diego, CA
- Life Equity, LLC; Hudson, OH
- Life Settlement Corporation d/b/a Peachtree Life Settlements; Boca Raton, FL
- Living Benefits Financial Services, LLC; Minnetonka, MN
- Stone Street Financial, Inc.; Bethesda, MD

General Members must either be institutionally funded Life Settlement providers who are licensed as such in at least one state, or an institutionally funded financing entity of Life Settlement providers with such activity being the financing entity's primary business. Each General Member must have a financing commitment of at least $50 million dollars.

600 Cameron Street, Alexandria, VA 22314 ▸▸ (703) 340-1692 Fax: 703-340-1642
www.LifeSettlementInstitute.org

**WRITTEN STATEMENT OF**
**STEPHEN B. MERCER, ESQ.**

**To Be Included in the Hearing Record of**

**The Subcommittee on Oversight and Investigations**

**Committee on Financial Services**

**"Retirement Protection: Fighting Fraud in the Sale of Death."**

**February 26, 2002**

**Preliminary Statement**

My name is Stephen Mercer, and I am an attorney in private practice at the firm of Sandler & Mercer, PC in Rockville, Maryland. Today, I have been asked to testify because of my experiences representing "viators," or people with a shortened life expectancy, who sell their life insurance policies. I have been working in the field of viatical settlements since approximately 1992, when I began to volunteer at the Whitman-Walker Legal Services Clinic here in Washington, DC. As many of you may already know, Whitman-Walker is a non-profit organization that provides a wide range of vital services to persons living with HIV and AIDS in the Washington, DC metropolitan region.

In 1994, Laura Flegel, the Director of the Legal Services Clinic at Whitman-Walker, asked me to assist her staff in drafting a chapter on viatical settlements for the Clinic's AIDS Advocacy Manual that is published in conjunction with the DC Bar Association. At that time, the nascent business of viatical settlements was booming, but there was little information readily available to the HIV and AIDS legal community about the mechanics of the sale of a life insurance policy and the extent to which state or federal law provided any protections for the viator. My early

work with the Whitman-Walker Legal Clinic in this area has continued to today, and has led to my representation of individual viators seeking advice and guidance related to a viatical settlement, as well as viators who have been harmed by unscrupulous practices in the sale or subsequent administration of their policies.

My testimony today briefly profiles three persons whose individual experiences with viatical settlements illustrates three of the most common abuses viators suffer in the marketplace: (1) Deceptive sales practices; (2) lack of meaningful confidentiality protections before and after a viatical settlement; and (3) unreasonably low purchase offers due to unfair trade practices, greedy viatical settlement companies, and inflated commissions paid to viatical brokers and financial planners. These common abuses illustrate the immediate need for uniform regulation intended to structurally change the existing business of viatical settlements in a fundamental way. Viators, like investors, are consumers who have a stake in a robust viatical settlements marketplace, and if the business of buying and selling life insurance policies is to continue (and it should), it must be changed in certain basic ways on a national scale.

I see first hand how persons living with the stress of a terminal or chronic health condition benefit from cashing out their policies, and I desperately want viatical settlements to continue to be a practical option for persons with HIV and AIDS to increase their liquidity. At the same time, I plainly recognize that the viatical settlements business model as currently structured is in the "end game" because of the rampant abuses and fraud inflicted upon individual investors,

many of whom are retirees or other persons with limited assets that can least afford to be scammed. In short, my view from the trenches is that viatical settlements offer a vast potential to assist certain terminally and chronically ill persons, while at the same time paying a reasonable rate of return to qualified investors, but that as the marketplace is currently structured, no one should be putting a dime into it.

The structural flaw in the business model of viatical settlements is that the "middleman" in the transaction, i.e., the viatical services provider who matches a seller of a policy with an investor, has every incentive to prey upon the vulnerabilities of each but no incentive to fairly reward either party. That is, the incentive of the "middleman" or viatical settlements company, is not to efficiently match a particular viator with a qualified investor, but to maximize the commissions, administrative fees, and markups associated with the viatical transaction. It should come as no surprise that in the marketplace of viatical settlements viators are getting too little cash for their policies and investors are paying far too much. The practical solution is to create an incentive for viatical settlement companies to profit from efficiently pooling the risks and spreading the rewards of viatical settlements among many viators and investors. This will never happen however, so long as viatical settlement companies can evade federal securities law by fractionalizing ownership of individual policies among several investors.

**Profiles of Abuses in the Marketplace**

**Client No. 1:** Client 1 is a person living with HIV who had a job that offered him group life insurance. Client 1 wanted to sell his policy, and he applied with a viatical settlements broker who told him that if he quit his job he could convert his group policy to an individual policy and sell it for $135,000.00 (about 60% of the death benefit). Client 1 relied upon the viatical settlements broker who held itself out as an advocacy group that represents and assists terminally ill persons and seniors who need to immediately sell their life insurance policies. This broker claimed to have special knowledge and expertise that would economically benefit Client 1. The broker maintained constant contact with Client 1, gathered information about Client 1's employment and benefits, and stressed the need to move quickly because any delay could lower the selling price of the policy. The broker also assured Client 1 that he could obtain more life insurance at his next job that he would be able to sell. Client 1 quit his job, but then was devastated to find out that he could not sell his policy because his group policy prohibited conversions to an individual policy in his circumstances.

**Client No. 2:** Client 2 is a person living with HIV who sold his life insurance policy over 5 years ago. Since then, he has received periodic emails and postcards from the viatical services company that was administering his policy, which he always responded to. Clearly, Client 2 has outlived whatever life expectancy the viatical settlements company induced individual investors to believe. (This is the primary risk investors face). Recently, while reviewing his personal

medical file at his doctor's office, Client 2 discovered that a complete set of his confidential medical records had been provided to the viatical services company on the basis of a medical release that purported to contain his signature but which he had not executed or authorized. Client 2 was further alarmed to find out that the underlying viatical sales agreement did not contain any covenants regarding confidentiality despite the pre-sale assurances of confidentiality made by the viatical settlements broker.

**Client No. 3:** Client 3 is a person living with HIV who wanted to sell his life insurance policy with a death benefit of over $400,000.00. He does not suffer from any end stage complications, and the only viatical settlement broker who would consider the purchase offered him approximately 4% of the face value, or $18,000.00. The broker justified this price because of the scarce funds available from investors for longer term investments in policies. Nevertheless, the broker earned a 50% commission ($9,000.00) on the purchase price, and if the rule of thumb for sales to investors is accurate (face value divided by 2.5), the selling price to the investors was in the neighborhood of $160,000.00, leaving an approximately $133,000.00 mark up for the viatical settlements company that "packaged" the policy for sale; plenty of cash to pay an exorbitant sales commission (usually in the neighborhood of 10%) to the financial planners who brought the individual investors to the transaction.

These Client profiles illustrate the deceptive sales practices rampant in the viatical settlements marketplace, the lack of meaningful confidentiality protections before and after a viatical

settlement, and the unreasonably low purchase offers and unabashed greed of the viatical settlement companies, brokers, and financial planners involved in the transaction. These abuses harm consumers, whether they are viators/sellers of life insurance policies or individual investors. These abuses occur because the viatical settlements companies, brokers, and financial planners are driven by high fees, commissions, and administrative charges instead of a profit incentive to reward investors with reasonable rates of return. State insurance regulation of the viatical settlements business will not alter this structure; indeed, it may have the unintended consequence of solidifying the marketplace as it currently exists. A basic restructuring of the viatical settlement transaction is necessary to remove the incentive for high fees, commissions and charges.

**State Regulation of Viatical Settlements Does not Address Structural Problems in the Marketplace.**

State regulation will not alter the basic dynamics of the viatical settlements transaction. To the contrary, allowing states to regulate viatical settlements as an insurance related product locks the industry in place and prevents it from making necessary changes to minimize abusive and fraudulent practices that harm viators and investors. The principal reason why there is so much opportunity for abuse and fraud is that viatical companies do not have a stake in the policies that they buy from viators and sell to investors. Viatical companies fractionalize ownership in an

individual policy among individual investors, for example, a $400,000.00 policy might be divided up among five investors, each of whom is listed with the carrier as an owner of the policy. This has adverse consequences for the viator/seller's confidentiality, and it magnifies the greatest risk to the individual investor of the viator/seller living longer than anticipated. It would be more efficient for a viatical company to be the owner of the policy, as well as many other policies, and to sell shares in the viatical company to investors. This would provide for greater confidentiality of the viator, spread the risk of longer life expectancy over many policies, provide greater liquidity of investment for an investor, and give the viatical company a profit stake in reducing fraud in the underlying transactions. In turn, there should be more funds available to purchase policies from persons with HIV/AIDS, even though they may be enjoying longer life expectancies.

This will never happen however, because in SEC v. Life Partners, 87 F. 3d 536 (1996), the D.C. Circuit determined that directly fractionalizing an ownership interest in a life insurance policy among several investors does not constitute a "security" within the meaning of the federal securities acts. Thus, viatical companies have an incentive to avoid the scrutiny of federal securities law by maximizing the risk of the viatical settlement to an individual investor. Moreover, because the viatical companies do not share in the profit or losses of policies, they have little incentive to ferret out fraudulent transactions instead of merely flipping bad policies onto unsuspecting investors. The costs of compliance cannot be greater than the amounts consumed by the viatical companies now for commissions and fees, and in any event, the

investor scams will bring an end to the market soon enough, to the detriment of prospective viators.

**Conclusion**

From the perspective of viators today, money is scarce to purchase life insurance polices, which means that the viator gets paid less. Improved treatments for persons living with HIV and AIDS will result in lower offers, but it is the investment scams associated with the transaction that will bring about the end of viatical settlements. So long as viatical settlements are not subject to federal securities law these frauds will continue. Legitimizing the viatical settlements industry can only benefit prospective viators who have a stake in there being a marketplace for their policies.

With advances in treatments for HIV and AIDS, investors should be wary of getting locked into a fractional interest in a single life insurance policy in the event an individual insured lives longer than is expected. However, HIV/AIDS continues to drastically shorten the life expectancy of individuals, and if investors could spread the risk of an individual insured living longer over a larger pool of viators, and realize a secondary market for the sale of their shares to increase liquidity before the investment matures, more funds could be available to purchase policies. This will never happen, however, because viatical settlement companies can now avoid compliance

with federal securities law by making the individual investor a fractional owner of a particular policy, instead of the viatical settlement company owning the policy and selling shares to investors. Only in the latter scenario does the viatical settlement company have an actual stake in reducing fraud in the transaction.

In summary, while states have a role in regulating viatical settlement companies, the primary regulatory tool to reshape the market is application of federal securities law. Federal regulation will put out of business those that should not be there in the first place, and bring into the market companies that will benefit viators and investors.

Thank you for the opportunity to present my viewpoint of these matters.

## State Viatical Laws

| State | Grade | NAIC Model Law Rev. A | Financial Licensing Requirements | Fraud Provisions | Advertising Standards | Securities Regulation | Consumer Protections |
|---|---|---|---|---|---|---|---|
| Delaware | F | No | No | No | No | No | Securities regulators issued a policy statement |
| Florida | A+ | current | Yes | Yes | Yes | Yes | By regulation |
| Hawaii | F | No | No | No | No | Yes | Advertising materials to be filed Disclosure to purchaser; right to rescind |
| Kansas | B- | 1993 | Yes | No | Yes | No | Contract must be approved by Commissioner |
| Kentucky | B- | 1993 | Yes | Yes | No | Yes | Disclosure requirements |
| Maryland | F | No | No | No | No | No | Securities regulators analyze investment contracts |
| Connecticut | B | 1996 | Yes | No | Yes | No | Consumer protections similar to model |
| Delaware | C | 1998 | Yes | No | No | Yes | Consumer protections similar to model |
| District of Columbia | F | No | No | No | No | No | None |
| Florida | A+ | current | Yes | Yes | Yes | No | Consumer protections similar to model |
| Georgia | F | No | No | No | No | Yes | Securities regulators will review investment contracts |
| Hawaii | F | No | No | No | No | Yes | Securities regulators will review investment contracts |
| Illinois | C- | 1993 | Yes | No | No | No | Disclosure requirements similar to model |
| Indiana | B- | 1993 | Yes | No | Yes | Yes | Consumer protections similar to model |
| Iowa | A | By regulation | Yes | Yes | Yes | Yes | Must provide disclosures |
| Kansas | C | 1998 | Yes | No | No | Yes | Must provide disclosures |
| Kentucky | A | 1998 | Yes | Yes | Yes | Yes | Consumer protections similar to model |
| Louisiana | C- | 1993 | Yes | No | No | Yes | Consumer protections similar to model |
| Maine | A | 1998 | Yes | Yes | Yes | Yes | Disclosure requirements similar to model |
| Maryland | C- | 1993 | Yes | No | No | Yes | Securities regulators review investment contracts |
| Massachusetts | B | 1998 | Yes | No | Yes | Yes | Disclosures from model |
| Michigan | C- | 1993 | No | Yes | No | Yes | Disclosures similar to model |
| Minnesota | B- | 1993 | Yes | No | Yes | Yes | Securities regulators review investment contracts |
| Mississippi | B | 1998 | Yes | No | Yes | Yes | Includes disclosure requirements |
| Missouri | F | No | No | No | No | Yes | Securities regulators review investment contracts |
| Montana | B- | 1993 | Yes | No | Yes | Yes | Disclosure requirements similar to model |
| Nebraska | A+ | current | Yes | Yes | Yes | Yes | Disclosure requirements similar to current model |
| Nevada | A+ | current | Yes | Yes | Yes | No | Disclosure requirements similar to current model |
| New Hampshire | F | No | No | No | No | Yes | Securities regulators review investment contracts |
| New Jersey | B | 1998 | Yes | No | Yes | Yes | Disclosure requirements similar to model |
| New Mexico | C | 1998 | Yes | No | No | Yes | Disclosure requirements similar to model |
| New York | B- | 1993 | Yes | No | Yes | Yes | Disclosure requirements |
| North Carolina | A+ | current | Yes | Yes | Yes | Yes | Disclosure requirements similar to model |
| North Dakota | B+ | current | Yes | Yes | No | Yes | Disclosures similar to model |
| Ohio | A+ | current | Yes | Yes | Yes | Yes | Disclosure requirements from model |
| Oklahoma | A | 1993 | Yes | Yes | Yes | Yes | Disclosure requirements from model |
| Oregon | C- | 1993 | Yes | No | No | Yes | Disclosure requirements from model |
| Pennsylvania | B+ | current | Yes | Yes | No | Yes | Disclosures and consumer protections |
| Rhode Island | F | No | No | No | No | No | None |
| South Carolina | F | No | No | No | No | Yes | Securities regulators review investment contracts |
| South Dakota | F | No | No | No | No | Yes | Regulated as security |
| Tennessee | A | 1998 | Yes | Yes | Yes | Yes | Disclosures from model act |
| Texas | B- | No | Yes | Yes | Yes | Yes | Regulated as insurance |
| Utah | F | No | No | No | No | Yes | Regulated as security |
| Vermont | C- | 1993 | Yes | No | No | Yes | Some disclosure requirements |
| Virginia | C- | 1993 | Yes | No | No | Yes | Disclosure requirements from model |
| Washington | C- | 1993 | Yes | No | No | Yes | Disclosure requirements similar to model |
| West Virginia | F | No | No | No | No | No | None |
| Wisconsin | C- | 1993 | Yes | No | No | Yes | Disclosure requirements from model |
| Wyoming | F | No | No | No | No | No | None |

*Prepared by Committee staff based on data provided by the NAIC; Letter Grade based on equal weighting of first 4 columns*

**Rep. Luis V. Gutierrez, Ranking Member**
**Oversight & Investigations Subcommittee Hearing**
**"Retirement Protection: Fighting Fraud in the Sale of Death"**
**Questions for the Hearing Record**
**2-26-02**

**Questions for Steve Mercer**
**Partner, Sandler & Mercer**

1) Would it be in the public interest to prohibit the sale of life insurance policies to investors?

2) How could we ensure that confidentiality of information is guaranteed to better protect viators?

**Questions for Mr. Lee Covington, Director, Ohio Department of Insurance and Mr. Thomas Geyer, Assistant Director, Ohio Department of Commerce**

1. How might federal action or legislation help prevent or reduce future occurrences of such fraud?

2. Which states are most effective in combating fraud? Which are least effective?

3. Is it possible for states to prevent and/or combat fraud without the help of federal agencies?

4. How many fraud victims have filed complaints with your agency? How were these complaints handled?

5. Can you estimate the number of other victims who never filed complaints?

6. Can you estimate the financial impact when retirees lose their life savings? (e.g., application for reduced utility rates, need for medical services they cannot afford, housing, etc.)

**Mr. David M. Lewis, Esq.**
**General Counsel, Stone Street Financial**

You made several proposals to the NAIC (National Association of Insurance Commissioners) Viatical Working Group for revisions to model regulations., all of which point to reducing the possibility of litigation by sellers (viators) or their families.

1. Do you anticipate a huge amount of litigation by sellers?
2. In the past 2 years how many lawsuits have been filed on behalf of viators or their families?

Your suggestions include a provision that viatical settlement providers "either employ or contract with life insurance underwriters with ten or more years of experience or use a licensed physician to determine life expectancies."

1. How many companies exist today that have 10 years experience in determining life expectancy for the purposes of viatication?

SUNNY
55°
more weather

Subscribe to the print edition click here

THE BLADE
toledoblade.com®
Monday, February 25, 2002



MARKETPLACE
click here
4
Brand New
Floorplans
Investment advice that works!
Fifth Third Securities, Inc.

Business

Local Companies | Article published February 24, 2002

# Liberte losses hit small city hard

## 4 dozen residents lost $3 million by investing in Toledo firm

By GARY T. PAKULSKI
BLADE BUSINESS WRITER

MADISON, Ind. - This isn't how LaVern Gross pictured retirement.

It's 2 in the afternoon and the septuagenarian, who made it through another restless night, waits for customers at the $6 car wash on the edge of town.

"I'll have to work until I die," shrugged Mrs. Gross, who returned to the working world as assistant manager of the car wash 21/2 years ago after losing a retirement nest egg of $63,000 in the collapse of Toledo's Liberte Capital Group LLC.

Sylvia Green, 80, of nearby Hanover, Ind., must live on Social Security benefits after losing $20,000 in Liberte Capital investments. (BLADE PHOTOS/LORI KING)
| Zoom |

The demise of the firm, whose Ottawa Hills owner has been indicted on conspiracy to commit fraud and money-laundering charges, has gone largely unnoticed outside Toledo. Bigger investment catastrophes, like the downfall of mighty Enron Corp, have captured national attention.

But four dozen Liberte investors in Madison and surrounding Jefferson County - including business owners, a former school superintendent, factory workers, and sales people - can think of little else but the $3 million they put into the Toledo firm that promised 14 percent returns.

Marion and Bill Howard hoped to use the

Their stories of lost homes, altered lifestyles, and frustration offer insight into the predicaments of 2,900 others nationwide who stand to lose $105 million invested with Liberte and owner J. Richard Jamieson between 1996 and 1999.

Madison, 45 miles northeast of Louisville, Ky., is a pretty city of 12,000

KidZone
GolfServ
Mud Hens Web Cam
SERVICES
Set As Homepage
Subscriber Services
Email Newsletter
Advertise
About Us
Contact Us
Help & FAQs

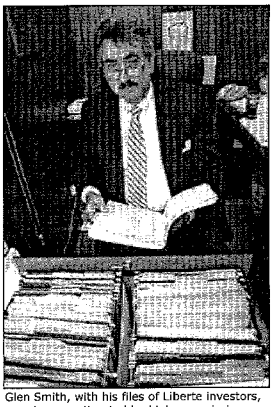
interest from their Liberte investments for vacations.
(THE BLADE/LORI KING)
| **Zoom** |

surrounded by tree-covered hills. Hugged by the Ohio River, with a Main Street lined with restored homes built by river merchants in the mid-1800s, it looks like a place where Tom Sawyer and Huck Finn would have played.

The river's most lucrative yield these days is tourists drawn to nearby casinos and riverboat gambling venues. But with a per capita income that, at $20,207, trails the state's by 23 percent, money doesn't come easy in Jefferson County.

That helps to explain why the Liberte losses were such a blow.

Investors here who didn't know each other before the firm's collapse meet periodically at a senior citizens center to hear updates on efforts to recoup their money from Mr. Jamieson, alleged co-conspirator James Capwill, and others. So far, Victor Javitch, a Cleveland attorney appointed receiver in the case, has collected about $13 million, or 12 percent of the money that Liberte owes investors.


Glen Smith, with his files of Liberte investors, says he was attracted by high commissions but is blameless for losses.
(THE BLADE/LORI KING)
| **Zoom** |

The investors from Madison have organized caravans to make the five-hour trip to Toledo to attend hearings in the case before U.S. District Judge David Katz.

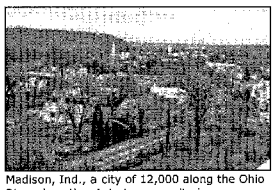
They even contributed money in late 2000 to send a local financial expert to Europe to negotiate with a German bank that they hoped would provide a partial bailout for Liberte investors. The talks proved unsuccessful, however. Liberte specialized in so-called viatical settlements, in which investors buy the rights to collect future insurance death benefits of senior citizens and people with fatal illnesses.

Mrs. Gross, the car wash employee, went to a few investor meetings but decided they were pointless. Nearly three years after word of serious problems at Liberte's downtown Toledo offices in April, 1999, she has yet to tell her adult son that her money may be gone. "I'm ashamed of it," she acknowledged. "I hate for people to know I was stupid enough to invest in it."

She puts in 40 to 50 hours at the car wash some weeks and is often awakened at night by thoughts of her lost money, which she accumulated in an earlier career at Sears.

For information about the case, she turns to the man who convinced her to invest in Liberte Capital: Glen Smith, a 66-year-old insurance agent in nearby Hanover, Ind.

His newspaper advertising and outdoor sign promoting Liberte's promised 14 percent return attracted local investors.



Madison, Ind., a city of 12,000 along the Ohio River, lags the state in per capita income. (THE BLADE/LORI KING)
| Zoom |

He acknowledged that many investors blame him for their predicament.

During a meeting with one elderly investor, the woman's daughter didn't try to hide her hostility. "Glen called my husband and me every day trying to get us to invest," she said. "I'm glad we didn't. My mother put everything she had in it. I advised her not to do it."

Complained the insurance agent: "It's ruined me. No one comes in to buy anything anymore. They look at me like they don't trust me. I was honest and they made me a crook."

But the Liberte controversy didn't cause all of Mr. Smith's troubles, he acknowledged. He also faces criminal charges, unrelated to business dealings, that arose in his personal life.

Concerning the Liberte situation, he said he is blameless, deceived just like his investors.

He was part of a network of 500 independent agents around the nation who peddled investments in Liberte. He makes no secret why he sold for the firm: an 8 percent commission. In 1998, he made more money than at any other time in his life. His taxable income that year was $185,000, he said.

But the money is gone, spent in part on legal fees to save his insurance license, which the state of Indiana tried to revoke, he said. He sold his home and sleeps in a back room of his office building.

The investors from Madison have organized caravans to make the five-hour trip to Toledo to attend hearings in the case before U.S. District Judge David Katz.
| Zoom |

Lawsuits filed Feb. 8 in Jefferson County Superior Court by three investors accuse Mr. Smith of fraud and malpractice. He "knew or should have known" that the viatical settlement contracts to which he steered investors "were extremely risky and possibly worthless," the complaint states.

Experts say that such transactions can be entirely legitimate. The viatical industry started in the early days of AIDS to get money to cash-strapped sufferers.

Federal prosecutors allege, however, that Liberte knowingly purchased the future rights to collect on policies covering people who concealed positive HIV tests and other health conditions. The firm then used these policies as backing for millions of dollars in investments without warning potential investors that if the fraud were detected, insurance companies might cancel the policies and render the investments worthless. Some insurers voided policies sold by Liberte.

Mr. Jamieson and Mr. Capwill have pleaded not guilty, although no trial date has been set. They were charged Jan. 18 in a 160-count indictment.

Sylvia Green, of nearby Hanover, Ind., knew nothing about the risks when she invested $20,000 in Liberte in 1998 and 1999.

A letter she received from the Toledo firm indicated that half her investment was used to buy a 2 percent interest in a $1 million policy covering a man who had four to five years to live after learning he was HIV positive a year earlier.

"Your investment ... will go a long way to helping him live his last days in better financial comfort," a Liberte representative wrote. "We commend you for your noble decision to participate in this transaction and to help a complete stranger in desperate need."

Prosecutors say that many people who sold policies to Liberte ran from insurer to insurer obtaining coverage that they quickly brokered to the firm. Fifteen of them have been indicted in the case.

Now, the 80-year-old doesn't know whether she will see the money again. "It's everything I got," said Mrs. Green, a homemaker whose late husband worked in housekeeping at a nearby psychiatric hospital.

Her only income is Social Security benefits. After paying medical insurance premiums, she has about $800 left each month. She doesn't know how she will pay for roof repairs for her 34-year-old mobile home. When her car needed extensive transmission repairs, she had to take out a bank loan.

Mary Faye King, 82, invested $60,000 in Liberte. When checks stopped coming from the Toledo firm, she was no longer able to afford upkeep on her home and moved in with a daughter and son-in-law. "She didn't let me know it happened and was living on practically nothing," said the daughter, Clair Kidwell.

Life is also different for Bill Howard, 65, and his wife, Marion, 61. A retired construction supervisor who operates a small cattle farm near Hanover, Mr. Howard said he and his wife had hoped to use interest from $65,000 invested with Liberte to take vacations. "We can't do nothing," he said. "We're hurting."

To purchase a new car recently, the Howards had to sell some of their cattle.

A portion of the money invested with Liberte came from an inheritance Mrs. Howard received from her parents. She has difficulty talking about the situation, often breaking down in tears when the subject comes up.

Like some investors, they haven't yet told their children. "We're ashamed of getting into something like that," said Mr. Howard, who is among investors suing the insurance agent who persuaded them to put money into Liberte.

"He's a good talker - like a car salesman," Mr. Howard said of Mr. Smith.

Houston Holland, a retired timber company operator and railroad worker, doesn't blame the insurance agent. "He isn't responsible," said Mr. Holland, of nearby Canaan, Ind. "But he could have been more diligent."

Mr. Holland lost $100,000 in the Liberte collapse and said the stress has contributed to his and his wife's deteriorating health.

The 75-year-old is frustrated about the time it is taking lawyers and prosecutors to resolve the matter. It has been nearly three years since signs of serious problems surfaced at Liberte and almost two years since the U.S. Justice Department seized records and froze the assets of the firm.

Lawyers reply that it takes time to recoup funds and sort through competing arguments about how the proceeds should be divided. Gerald Kowalski, a Toledo attorney who represents investors, said it is impossible to say when they might

see any money.

Complained Mr. Holland, "This is going to be dragged out until there isn't a dime left for the investor."

As a result of the Liberte problems, Mr. Smith, the insurance agent, is talking about leaving the area that has been his home since childhood. "I'm going to move to Texas as soon as the people get all their money back," he said during an interview in his office.

"Then you'll never go to Texas," Mr. Holland replied.

**Article Features »**

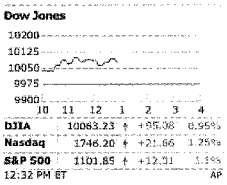
Printer-friendly version
Forum on this topic
Email to a friend

**| Advanced Search by Keywords »**

View the Local Companies index
View the Business index

**AP Wall Street News »**

| Index | Last | Change |
|---|---|---|
| Dow | 10080.66 | +112.51 |
| Nasdaq | 1751.40 | +26.86 |
| S&P 500 | 1099.38 | +9.54 |




**Quick Quotes**

Go

**Calculators »**

Home mortgages
Stocks
Credit cards
Budget
Home equity loans
Mutual funds
Retirement
Savings
Automobiles
Bonds
Insurance
Roth IRAs

**Subcategories »**

Agriculture
Automobiles
Employment
Local Companies
Personal Finance
Real Estate
Regional Economy
Stock Market
Technology
Unions

AdvertisingNet

©2002 The Blade. Privacy Statement. By using this service, you accept the terms of our visitor agreement: Please read it.

The Toledo Blade Company, 541 N. Superior St., Toledo, OH 43660, (419) 724-6000
To contact a specific department or an individual person, click here.

March 9, 200

Luper, Sheriff & Neidenthal
1200 LeVeque Tower
50 West Broad Street
Columbus, Ohio, 43215-3374

Dear Mr. Luper:

I am writing to see if you or who ever I can receive any news, The last I heard from you was Dec. 15, 1999. You said in the letter you were the receiver in the Case Liberte Capital Group. I treasure your letter, I have no other one to contact, The broker sold us our Vicitial Escrow, (Joe Lavelace - Altamonte Spring, Fl. 32714) He has skipped out, No one knows where? I can't afford a lawyer. My husband has Alheimer's, this has hit me hard, He is very bad. I need all the help we can get. If you have any news, please contact me. Sorry to be any trouble, This deasie (Alheimer's) could hit any one, I surly hope not.

We are Seventy Nine yrs old,
This money was our savings
we will suffer because of people
like this Broker that sold this
Viatial Escrow. He will surely
be punished according to
Gods Word. Sincerely

My Phone No.
706-291-7245

Mrs. Gertrude Waid
425 Fred Kelly Rd.
Rome, Ga. 30161

July 3, 01

Gerald R. Kowalski, Esq.
Cooper & Walinski
900 Adams Street
Toledo, Ohio, 43624

JUL 0 9 2001

Re: Liberty Capital Class Action Case 5-99-CV818

We received your notice of the referenced class action .

Our investments are:

Sam Kiser $35,000 From IRA ss## 246-36-7458
Margaret R. Kiser $50,000 SS # 244-28-1713

Copies of original proof attached hereto.

We were assured by the seller that this investment was very safe and protected by the N.C. Insurance fund in case of default. Copy of the brochure indicating this is attached. The insurance department commissioners office says that this is not true. Our decision to purchase Viaticals was influenced by the statements made and the listing on the brochure.

Presently, we live on social security income and any loss of our investment would be extremely damaging to our welfare.

Please do speak for us at the August 31st. hearing.

We are innocent victims in this case and are very disturbed that our trust in this investment was wrongfully handled.

Sincerely,

Sam Kiser - Margaret R. Kiser

Samuel & Margaret Kiser
P.O. Box 774
Graham, N.C. Phone; 336-578-1128

November 13, 2000

The Honorable David A. Katz
United States District Court
United States Courthouse, Room 215
1716 Spielbusch Avenue
Toledo, Ohio 43624

The Honorable David A. Dowd, Jr.
United States District Court
U.S. Courthouse - Federal Building
2 South Main Street, Room 402
Akron, Ohio 44308

The Honorable James S. Gallas
United States District Court
U.S. Courthouse - Federal Building
2 South Main Street, Room 480
Akron, Ohio 44308

Re: U.S. v. J. Richard Jamieson, et al 300CV7312
Liberte Capital Group, LLC v James A. Capwill, et al 99CV818

Dear Sirs:

The purpose of this letter is two fold. First, I would like to take this opportunity to briefly provide you one investor's personal view of the tragic chain of events which has so unmercifully touched the lives of countless investors like myself, whose dreams of a modest financial investment culminated in the instantaneous loss of a life's savings though the incomprehensible and intentional deceit, fraud, and misappropriation perpetrated by Mr. Capwill and Mr. Jamieson, of Liberte Capital Group, LLC.

I am a career law enforcement officer with 27 years of state service. Two years ago I learned of the investment opportunities that Liberte Capital Group, LLC, was offering. In speaking with one of their brokers I was guaranteed that my investment was insured against fraud, theft, or fraudulent policies. I was careful to ensure through my agent that there was no risk and that my investment was secure. Consequently, I invested my entire retirement savings of $100,000. I was shocked to learn that my broker, who represented Liberte Capital Group, grossly misrepresented to me the relative risk factors and failed to provide me accurate information about the insurance and security issues associated with my investment. In other words, I was assured that my investment was secure.

If I am unable to recover my investment I may never be capable of retiring and will be forced to work indefinitely. This is a sad ending to a distinguished 30 year law enforcement career.

As it is, the failure of the investment company to make good on their promises could force me to withdraw my two daughters from college after a lifetime of saving and investing for their education. In addition to the numerous financial hardships I will subsequently incur, my wife and I have developed medical problems which have been aggravated due to the stress-induced trauma associated with this terrible ordeal.

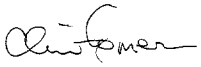
Lastly, I want to extend my deepest appreciation for the aggressive and forthcoming efforts you have supported and/or facilitated to allow the United States Attorney, Mr. Seth Uram, and the court appointed receiver, Mr. Victor Javitch, to retrieve the funds which rightfully belong to the victims, otherwise known as investors.

My family has suffered indescribable hardship and mental, physical and emotional distress because of the developments associated with the Liberte Company investment venture(s). I believe that the intentional fraud and gross negligence practiced by the investment executives and brokers should serve as an incentive to expedite this and related cases so that other investors will not suffer the traumatic nightmare that I have endured through the last few months.

In closing, I can only hope that you continue to understand the tragic hardships that the unconscionable acts committed by Mr. Capwill and Mr. Jamieson have caused me and many others like me. I hope that you will continue to vigorously pursue and support the government's attempt to retrieve the victims' (investors') monetary investments. This investment was our "future" and will impact my family for many years to come.

Should you have any questions, please contact me at (530) 926-1626.

Sincerely,



Clint Comer

P.O. Box 1626
Mount Shasta, CA 96067

8/20

JUL 0 2 2001

June 28, 2001

Dear Mr. Gerald Kowalski and Mr. Andrew Storar;

I am a Liberte Capital investor to the tune of $119,000, and I was very grateful to receive your mailing today as it has been so hard to get information on this investment the loss of which has destroyed me financially. My name is Donna L. Robinson, and my late husband and I resided in Plant City, FL at the time we made this investment. My husband Roger died on June 17, 1999 at the age of 65 shortly after he heard that these investments could be lost. They were our life savings. I had to give up our home and move into an apartment when we lost this money. I am now at the Paddock Club address that is on my mailing, but I am being married tomorrow. My new name and address as of July 20th will be Donna Robinson Westphal, 8424 Laurelon Place, Temple Terrace FL 33637. My phone number will be 813 899 4913. My Email address is DRobi14366 @aol.com. I would appreciate it if you could do this address change.

At the time of my husband's death I sent a death certificate to Liberte Capital.

I want to participate in this class action lawsuit to the fullest extent, and I am most grateful to both of you that this action is being taken. God bless you both.

Donna Robinson Westphal 8424 Laurelon Place, Temple Terrace, FL 33637.

Investors

AUGUST 11, 1999

MR. FREDERICK LUPER, ESQ.
50 WEST BROAD STREET
SUITE 1200
COLUMBUS, OHIO 43215

DEAR MR. LUPER,

MY WIFE AND I ARE BOTH RETIRED SENIORS AND BOTH NOT IN THE BEST OF HEALTH, AND LIVE ON A VERY LIMITED INCOME. WE WITHDREW A GOOD PORTION OF OUR SAVINGS FROM SAFE BANK CD'S IN THE AMOUNT OF $100,000 AND INVESTED IT IN LIBERTE CAPITAL VIATICAL CASH FLOW PLAN WITH THE INTENTION OF RECIEVING A HIGHER INTEREST RATE.

THE INVESTMENT MATURED JULY 16, 1999, AND WE SADLY LEARNED OF ALL THE LITIGATION PROBLEMS OF LIBERTE CAPITAL. WE NEVER RECIEVED THE JULY 1ST DISTRIBUTION WHICH WE DESPERATLY NEED, AND NOW ARE LOSING INTEREST ON THE PRINCIPLE, NOT EVEN KNOWING WHEN IT AND IF IT WILL BE RETURNED.

WE CAN'T TELL YOU ENOUGH HOW WE NEED THESE FUNDS IN ORDER TO LIVE A LITTLE BETTER THAN WE ARE. WE WOULD APPRECIATE IT VERY MUCH IF YOU CAN TELL OR REASSURE US WHEN IT WILL BE RETURNED OR GIVE US ANY DIRECTION AT ALL.

THANK YOU. Sol Woloshin Myrna Woloshin

SOL AND MYRNA WOLOSHIN
1020 N.W. 106TH AVENUE
PLANTATION, FLA 33322 (954) 424-9540

Investors

August 10, 1999

Frank Luper
50 W. Broad St.
Suite 1200
Columbus, OH 43215
(PH. 614-221-7663)

Dear Mr. Frank Luper,

My name is Bertha Siegrist, and I am an investor in Liberte Capital Group, L.L.C.

Mr. Butch Ward an, agent of L.L.C., came to my home on many different occassions trying to get me to invest in Liberte Capital Group, L.L.C. Since he has been my Health Insurance agent for a number of years, and has always been, in the past, honest, and truthful, I trusted him with my life savings, which I worked very hard for.

I have invested my life savings of, one hundred thousand, (100,000) dollars, starting date, April 22, 1998. I have drawn interest on seventy five, (75,000) I invested for, four (4) quarters, the balance of the interest along with my seventy five, (75,000) was due to me, (Bertha Siegrist), on April 22, 1999.

I also invested another twenty five, (25,000) on the same date, April 22, 1998 with interest due on October 22, 1999, along with the

twenty five, (25.000).

Please, Mr. Frank Luper, I need the freeze lifted, (as soon as you can) off of the entire hundred thousand (100,000) for me to live on, pay my Health Insurance, Property Tax, Medical Care, Car Insurance, Electric, and telephone bills. etc..., and whatever is left over for food.

Thank you very sincerley

Bertha Siegrist
3704 W.S. Rte 127
Celina, OH 45822
(419) 925-5153

P.S.; Please Reply soon.

| Policy No.'s are: | | P.O.#'s |
|---|---|---|
| | D. Butler | 0341775 |
| | D. Mitchell | 46238259 |
| | J. Krug | 392010 |
| | B. Mitchell | 1422032 |
| | L. Savage | 1780242-6 |
| | J. Koster | 1547631 |
| | P. Hamby | 14438673 |
| | C. Carpistone | 77871244 |
| | W. Schade | AA9800552 |
| | S. Jackson | 002670040U |
| | B. Adams | 2-140-645 |

PLEASE RETURN MY MONEY,
I PRAY EVERY DAY YOU WILL.

Written Statement to :
The Oversight and Investigations Subcommittee of the
Financial Services Committee

February 26, 2002

Andrew C. Storar Esq.
2700 Kettering Tower
Dayton, Ohio

and

Gerald R. Kowalski Esq.
900 Adams St.
Toledo, Ohio

Ladies and Gentlemen:

Unfortunately the situation Mr. Lazar has described to you is not unique. More than two thousand seven hundred individuals for across the United States find themselves in a very similar predicament. Many of the people are senior citizens that invested their life savings and this number applies to just the Liberte Capital group of investors. There are undoubtedly many more. Hence, the need for uniform regulation.

The viatical industry can be briefly described: An individual who owns a life insurance policy finds him or herself in financial need. There are viatical companies such as Liberte that will purchase the insurance policy at a discount from the death benefit. The amount of discount is often determined by the life expectancy of the insured. The longer the life expectancy, the deeper the discount as some funds are required to pay premiums on the policy until the insured expires.

After purchasing the policy the viatical company sells fractionalized interests in the death benefit to investors such as Mr. Lazar and the other members of the Liberte Class of investors. The money they pay the viatical company refunds its purchase price, is used to continue premium payments and is profit to the company. Upon death of the insured (viator) the death benefit is paid to the investors pro rata to their investment.

Handled properly and honestly the industry can be beneficial to a number of people. An individual who learns they are terminal may have an immediate need of funds for medical treatment. The payment they receive can help with that. Also, investors can realize an attractive rate of return on their investment.

The problem, of course arises when unscrupulous individuals get involved. In our case the Dept. Of Justice has determined that of the approximately one thousand policies in the Liberte portfolio nearly two thirds were obtained by fraud. This is accomplished when a viator knows he or she is terminal and then purchases a number of small insurance policies that do not require medical examinations. They simply lie about their medical condition on the policy application and then immediately sell the policies to a viatical company. If and when the insurer learns of the fraud the policy is often rescinded leaving the investor with nothing. In the Liberte case we have seen viators with as many as twenty policies.

We certainly believe the viatical company should at a minimum be suspicious when offered numerous small policies that have only recently been purchased. If suspicious, management at Liberte Capital was not driven to action as these policies were actively marketed to the public and most are worthless.

An additional area of concern is how the investors funds are handled once the investment is made. All policies require regular premium payments to remain in force. It is therefor, necessary that the viatical company maintain sufficient funds to maintain the portfolio.

Typically, the viatical company forwards funds to an escrow agent who then keeps the policies in force by making the required payments. That was done in the case of Liberte Capital. When trouble appeared the government became involved and lawsuits were filed. The Court has preliminarily found that the escrow agent mishandled in excess of Fifty Million dollars of money from Liberte investors and those of another viatical company. Hence, there has been very little available to maintain even the non fraud policies. As policies lapse for nonpayment individuals like Mr. Lazar lose their investment. The escrow agent is the subject of a multi-count indictment.

There also have been allegations that the viatical company did not forward sufficient funds to the escrow agent in the first instance and other indictments have recently been handed down.

In all, approximately One hundred Million dollars were invested with the Liberte Capital Group. About ten percent is presently accounted for.

It is important to point out that there has been very little regulation of this industry. Some states require that the investment be registered as a security as Ohio has recently done. Others do not. Being unregistered and unregulated all sorts of individuals marketed these investments in a variety of fashions. They were often described as safer than certificates of deposit and it appears older citizens were targeted.

We believe uniform regulation is required including registration, licensing those marketing the investments and regular reporting. Handled properly this industry can be a beneficial one. Left on its own we fear more stories like Mr. Lazar's.

Thank you

**THE DISTRICT OF COLUMBIA BAR**
**PUBLIC SERVICE ACTIVITIES CORPORATION**

**WHITMAN-WALKER CLINIC, INC.**

# AIDS ADVOCACY

***2001 Edition***

These materials were prepared by
Whitman-Walker Clinic Legal Services
for the Pro Bono Program of the
Public Service Activities Corporation
of the District of Columbia Bar
to assist volunteer attorneys.

100

# AIDS ADVOCACY
## VOLUNTEER ATTORNEY PRACTICE MANUAL

*2001 Edition*

Published March 2001 by
THE DISTRICT OF COLUMBIA BAR
PUBLIC SERVICE ACTIVITIES CORPORATION
*PRO BONO* PROGRAM

Produced by:
WHITMAN-WALKER CLINIC LEGAL SERVICES PROGRAM

*Main Office*
1407 S Street, N.W.
Washington, D.C. 20009
(202) 797-3527

*Northern Virginia Office*
5232 Lee Highway
Arlington, Virginia 22207
(703) 237-4900

*Managing Editors:* Laura Flegel and Mark Bonin
*Consulting Editor:* Caroline Polk

*We dedicate this to all of our clients, and to the memory of Gordon Braithwaite, John Rosenberg, Shirley Ann Sanders, and our long-time friend and fighter, Danny Reed.*

# CHAPTER VI

## VIATICAL SETTLEMENTS

A. DISTRICT OF COLUMBIA AND MARYLAND ..... VI-2

B. VIRGINIA VIATICAL SETTLEMENTS ACT OF 1997 ..... VI-2
1. Providers and Brokers Must be Licensed ..... VI-2
2. State Approval of Contracts ..... VI-3
3. Providers/Brokers Required to Disclose Key Information ..... VI-3
4. Medical Information Must be Kept Confidential ..... VI-4
5. Protections Against Coercion ..... VI-4
6. Insured May Rescind Contract ..... VI-4
7. Remedies ..... VI-4

C. FEDERAL REGULATION BY THE SECURITIES AND EXCHANGE COMMISSION HAS NOT BEEN APPROVED ..... VI-4

D. VIATICAL SETTLEMENT PROCESS ..... VI-4

E. ISSUES IN STRUCTURING VIATICAL SETTLEMENTS ..... VI-6
1. Valuation of Life Insurance Policies ..... VI-6
2. Determination of Life Expectancy ..... VI-8
3. Viatical Company's Cost of Capital ..... VI-8

F. IMPACT OF VIATICAL SETTLEMENTS ..... VI-8
1. Public Benefits ..... VI-8
2. Taxes ..... VI-9
3. Creditor/Debtor and Bankruptcy Issues ..... VI-10

G. ALTERNATIVES TO VIATICAL SETTLEMENTS ..... VI-11
1. Accelerated Death Benefits (ADBs) ..... VI-11
2. Third-Party Loans ..... VI-11
3. Partial Viatication ..... VI-12

## VI. VIATICAL SETTLEMENTS*

**by Stephen B. Mercer, Esq., and Elizabeth A. Seaton, Esq.****

*Note that Whitman-Walker Clinic Legal Services staff and its volunteer attorneys can provide general information and counseling regarding viatical settlements. However, the staff and volunteer attorneys cannot provide detailed review of specific proposed viatical contracts, give legal advice as to whether an individual should enter into a viatical contract or negotiate with viatical settlement companies on behalf of a client.*

An individual covered by a life insurance policy may be eligible for a variety of "living benefits" during his or her lifetime. Common benefits available to policyholders include cash surrender payments, endowment payments, annuities, and increasingly, accelerated or advanced death benefits.

Since the late 1980s and up to the middle of 1996 when new drug treatments for people with AIDS began to extend life expectancy rates, many people with advanced HIV infection used less widely recognized methods such as viatical settlements and third party loans secured with a life insurance policy to obtain current income. These tools are still available today for individuals with shortened life expectancies. But as new drug therapies have increased life expectancy rates for people living with AIDS, the availability and value of viatical settlements has decreased, and concerns regarding unscrupulous individual investors and issues of medical confidentiality have increased.

A viatical settlement is a contract between the owner of a life insurance policy (the viator) and a third party (the viatical settlement company). Generally, the viator/policyholder is also the individual whose life is insured by the policy (although the holder of the policy may be a spouse or business partner of the insured, or the group insurance plan itself). The viatical settlement company agrees to pay a discounted portion of the face value (generally between 50 percent and 80 percent of the full benefit) in exchange for ownership and control of the viator's policy and its benefits. To be eligible for a viatical settlement, the insured must be seriously ill and have a

---

*This chapter was last updated in December 1998.

**Stephen B. Mercer is a volunteer attorney in private practice and Elizabeth Seaton is the former associate director of Legal Services at the Whitman-Walker Clinic. This chapter was prepared with assistance from the late David Petersen and Thomas McCormack of Affording Care, Inc., and David S. Landay, Esq., president of National Viator Representatives. Additional materials were provided by Nancy Turner-Thompson, staff attorney, Whitman-Walker Clinic of Northern Virigina. The Whitman-Walker Clinic does not endorse or recommend Affording Care, Inc.; National Viator Representatives; or any other viatical settlement or viatical-related company.

short life expectancy (on average not more than one or two years), and the policyholder must not be barred by language in the insurance policy from assigning policy benefits to a viatical settlement company.

Because people living with HIV face staggering financial pressures, they frequently contact the Whitman-Walker Clinic Legal services program for information on viatical settlements. This chapter discusses the components of a standard viatical settlement. Please note that in 1997, the Virginia legislature enacted the Viatical Settlements Act, Va. Code Ann. §§ 38.2-5700 to 5707 (Supp. 1998), to deal comprehensively with the business of viatication. *See* Section B, below, for details on the new law. Neither the District of Columbia nor Maryland has similar provisions.

This chapter also explains the common effects of viatical settlements and offers suggestions for alternatives to viatication. Although a viatical settlement may be a valuable lifeline for many clients, it is not always the best option. Clients should be thoroughly advised of the viatical settlement process, its consequences, and other available options. Attorneys should make clients aware of the availability of certified financial planners to assist people in preparing for the financial consequences of long-term illness.

## A. DISTRICT OF COLUMBIA AND MARYLAND

As of the date of this printing, no regulations govern viatical settlements in these two jurisdictions. Before consulting with a client on this topic, advocates should check to see if new regulations have been promulgated. Several other states have passed regulations on viatical settlements.

## B. VIRGINIA VIATICAL SETTLEMENTS ACT OF 1997

In 1997, Virginia enacted the Viatical Settlements Act, Va. Code Ann. §§ 38.2-5700 to 5707 (Supp. 1998). The law requires licensure of viatical settlement brokers, and protects the insured through provisions prescribing disclosure, informed consent, unconditional refunds, and other measures. In addition, Virginia promulgated regulations to implement the new law that can be found in the Virginia Administrative Code at 14 VAC 5-71-10 (1998) *et seq.*

### 1. PROVIDERS AND BROKERS MUST BE LICENSED

Under the statute, as of January 1, 1998, people acting as viatical settlement providers and/or brokers must be licensed by the state. Va. Code Ann §§ 38.2-5701 to 5703. The Virginia Bureau of Insurance, a division of the State Corporation Commission, is responsible for issuing licenses to providers and brokers. 14 VAC 5-71-30. Counsel assisting a client should ask to see the provider's or broker's license (or at least his or her application for a license).

2. STATE APPROVAL OF CONTRACTS

Also beginning January 1, 1998, viatical settlement contract forms must be approved by the state before use by a provider or broker. Va. Code Ann. § 38.2-5704. You should ask whether the provider's or broker's form has been approved, and ask to see documentation. In addition, the statute allows for the state to establish standards for evaluating the reasonableness of payments under viatical settlement contracts. Va. Code Ann. § 38.2-5706. Pursuant to regulations outlined in the Virginia Administrative Code, a reasonable return for viaticating a life insurance policy is determined by the insured's life expectancy at the time of viatication. 14 VAC 5-71-60. The regulations require a minimum percentage of face value of the policy depending on the insured's life expectancy. *Id.* The prescribed percentage may be reduced by 5% for a policy written by an insurer who is rated less than the highest four categories by at least two rating agencies or by any outstanding loans received by the viator. *Id.* Currently, the Virginia regulations define reasonableness as follows:

| Insured's Life Expectancy | Minimum Percentage of Face Value |
|---|---|
| Less than 6 months | 80% |
| At least 6 but less than 12 months | 70% |
| At least 12 but less than 18 months | 65% |
| At least 18 but less than 24 months | 60% |
| Twenty-four months or more | 50% |

3. PROVIDERS/BROKERS REQUIRED TO DISCLOSE KEY INFORMATION

Under the new law, viatical settlement providers must also comply with comprehensive disclosure provisions. Much of the information that is required to be disclosed, especially related to taxes, outstanding debts, and public benefits, is the same information that Whitman-Walker Legal Services has been providing to clients for years. The disclosures must take place both at the time of solicitation for the viatical settlement, and at the time of contract signing. Va. Code Ann. § 38.2-5705. The provider also must retain in its files a signed disclosure form from the insured. § 38.2-5705 (A.6).

Providers now must inform people seeking to viaticate a policy that there are alternatives to viatication {§ 38.2-5705 (A.1)} and that proceeds may be taxable {§38.2-5705 (A.2}, may be subject to the claims of creditors {§ 38.2-5705 (A.3)}, and may affect their eligibility for Medicaid and other public benefits {§ 38.2-5705 (A.4)}. The provider must also inform the insured of the date by which the funds will be available and the source of those funds. § 38.2-5705 (A.6). A model disclosure form is provided in the Virginia Administrative Code at 14 VAC 5-71-30. However, a provider or broker may use a different form as long as it is "substantially similar" which means that it must address each and every element contained in the model form. 14 VAC 5-71-30.

4. MEDICAL INFORMATION MUST BE KEPT CONFIDENTIAL

Medical information solicited or obtained by a provider or broker must be kept confidential and only released as provided by law. § 38.2-5705 (B).

5. PROTECTIONS AGAINST COERCION

Before completing a transaction, the insured must provide a doctor's written statement that she or he is "of sound mind and under no constraint or undue influence." § 38.2-5705 (B). The client also must sign, and another person must witness, a document in which the viator consents to the contract; acknowledges his or her illness; represents that he or she understands the viatical process, releases his or her medical records, and acknowledges entering the contract freely and voluntarily. *Id.*

6. INSURED MAY RESCIND CONTRACT

A key provision of the Virginia Viatical Settlements Act is that the insured person has the unconditional right to rescind within 30 days of execution of the viatical settlement agreement, or within 15 days of the receipt of the proceeds, whichever is sooner. § 38.2-5705 (C). The provider must inform the person of this right at the time of solicitation for the viatical settlement, and again at the contract signing; the provider also must retain in its files a signed disclosure form from the insured. §§ 38.2-5705 (A to A.6).

7. REMEDIES

Violations of requirements imposed by the Viatical Settlements Act are considered unfair trade practices. Virginia law provides penalties, remedies and enforcement provisions that address unfair trade practices; these can be found at Va. Code Ann. § 38.2-200 *et seq.* Temporary and permanent injunctions are available; the enforcement of which may be by civil penalty or imprisonment. § 38.2-220. Also, for each knowing and willful unfair trade practice, a fine of up to $5,000 may be imposed; for other violations the fine is an amount up to $1,000. Va. Code Ann. § 38.2-218. Other remedies may be available as well.

## C. FEDERAL REGULATION BY THE SECURITIES AND EXCHANGE COMMISSION HAS NOT BEEN APPROVED

The Securities and Exchange Commission's (SEC) attempt to regulate certain forms of investments between buyer-brokers of life insurance policies and investors was rejected by the U.S. Court of Appeals for the D.C. Circuit. *See SEC v. Life Partners*, 87 F.3d 536 (D.C. Cir. 1996). Thus, the viatical settlement process is not subject to SEC regulation.

## D. VIATICAL SETTLEMENT PROCESS

To advise clients properly, attorneys should have a thorough understanding of the mechanics of the viatical settlement process. Companies generally will pay between 50 and 80

percent of the policy's face amount. However, recent breakthroughs in the fight against AIDS have driven down the prices companies are offering to pay for policies, and driven many institutional investors out of the viatical marketplace. The perception among investors that AIDS could become a chronic manageable disease is directly reflected by the lower prices being offered for policies as companies encounter greater risk to earn a 15 to 20 percent rate of return. Beyond a life expectancy determination, companies also base the amount paid on the valuation of a viator's life insurance policy, and the cost of capital to the viatical settlement company. The lawyer, therefore, should be familiar with life insurance policy valuation and issues relating to life expectancy determination.

Clients interested in pursuing a viatical settlement should speak with several companies, or a reputable broker, and compare proposed payments and other procedures and policies. Viatical settlement companies consider a wide variety of factors in determining whether to viaticate and for how much. Companies weigh pricing criteria differently, so different companies may offer varying prices for the same policy. Therefore, attorneys should encourage clients to contact as many companies as possible before settling on one. However, in light of advances in medical treatments for AIDS, companies may be reluctant to quote possible prices absent an extensive medical evaluation of the viator.

Whitman-Walker Legal Services does not endorse or recommend any particular viatical settlement company. Volunteer attorneys should not ever recommend a particular viatical settlement company to a client. Furthermore, as is discussed in this chapter, the option of viatical settlement is not appropriate or beneficial to all clients, and should be considered in relation to other options for each client.

Once a client has selected a viatical settlement company, the process typically takes from six to eight weeks to complete and involves the following steps:

1. Release of medical records by the insured to the viatical settlement company (accompanied by a life expectancy determination for the client made by his physician);

2. Provision of information about the insurance policy to the viatical settlement company or seller-broker (in either case the information will be confirmed with the insurer);

3. Presentation of an offer by the viatical settlement company;

4. Execution of closing documents, purchase agreement, and assignment of policy ownership, and placement of funds into escrow; and

5. Recordation of assignment by the insurer and release of funds to the viator.

## E. ISSUES IN STRUCTURING VIATICAL SETTLEMENTS

### 1. VALUATION OF LIFE INSURANCE POLICIES

Factors affecting valuation of a life insurance policy include: the type of policy; its face amount; any applicable period of contestability; whether the policy contains clauses restricting conversion or assignment; the cost of future premiums; lack of financial provisions for insured's dependents; and the rating and death-claims paying record of the insurer.

The two basic types of life insurance policies relevant to valuation are individual policies (term or whole) and group policies (employment-related). Below is a checklist of questions relevant to the valuation of a life insurance policy.

a. Is the policy an individual or group plan? Generally, an individual policy in the same face amount as a group policy will be valued higher because there are usually fewer parties who may affect the salability of the policy. The viatical settlement company perceives less risk when the owner of the policy, who is also the insured, makes an irrevocable assignment of all ownership rights.

b. Has the period of contestability passed? Typically this is a two-year period from the issuance of the policy. See Chapter IV, "Insurance and Employee Benefits," for information about periods of contestability in local jurisdictions. Verify that premiums since the original issuance have been paid. If a lapse occurred and the policy was reissued after past due amounts were paid, a new period of contestability likely will follow. Generally, policies subject to a contestability clause are not salable.

c. What is the face amount of the policy? Some viatical settlement companies will not purchase policies below a specified amount (although policies with a face amount of less than $5,000 have been purchased) because of the transaction costs, which include medical and legal advice. Policies with a face amount of $100,000 or more are those that are typically viaticated. Viatical settlement companies with available capital often prefer to invest in these larger policies because the transaction costs are lower than they would be if several smaller policies were viaticated. Clients with large insurance policies should consider the option of viaticating only a portion of their policy and retaining the balance for later viatication or as insurance to be paid to a beneficiary upon their death. *See* Section G.3, below, page VI-12.

d. Is there a disability waiver for payment of premiums? The existence of a waiver of premium reduces the cost to the viatical settlement company, and the viator/insured should benefit from it. If the insurer must be contacted to verify the existence of a disability waiver, you should first know whether the policy is still subject to a contestability clause. This is because the existence of a disability is not information that should be shared with the insurer if the policy might be successfully contested. An additional concern is whether the disability waiver needs to be recertified at regular intervals. If so, this may reduce the value of the policy to the viatical settlement company.

e. Does any clause restrict assignment? This issue usually arises in the context of group insurance but may also be present in an individual policy. Sometimes an insurer may waive this clause at the request of the policy owner; but again, you should know whether the period of contestability is in effect before sharing information about a disability with an insurer. If the policy contains a clause restricting assignment and the insurer refuses to waive the clause, then there is little chance the policyholder will be able to viaticate the policy.

f. Does the policy have a cash value? Does it have additional riders or acceleration of benefit provisions that must be addressed? Each of these issues may affect the price paid by the viatical settlement company. However, a high cash value or good accelerated benefits provisions might make viatication unnecessary. For a more complete discussion on alternatives to viatical settlements, *see* Section G, below, starting on page VI-11.

g. Has the insured made adequate financial provisions for dependents? Even with releases secured from currently named beneficiaries, a viatical settlement company may be reluctant to purchase a policy when the insured's dependents may later initiate legal action regarding the sale of the policy.

h. What is the rating of the insurer? Counsel for the client should review the insurer's rating in *Best Insurance Reports* (available in most public and law libraries). A higher rating for the insurer means less risk to the buyer and, therefore, more money for the seller.

i. Does the group policy limit whom may be designated as the beneficiary? Some group plans do not permit the participant in the group to name a corporate beneficiary or a beneficiary who is not a family member or relative. Such a restriction, similar to the bar on assignments discussed in Section E.1.e, above, will make viatication impossible unless the insurer agrees to waive this limitation.

j. Is the group policy a life and medical combination? Clients should be counseled not to risk the loss of medical insurance. Medical insurance is likely an asset of much greater value to a person living with HIV than the proceeds of a viatical settlement.

k. Is the group policy a federal or military policy? Many of the largest government and military group policies have some prohibition on assignments (other than as a gift). Servicemen's Group Life Insurance (SGLI) and Veterans' Group Life Insurance (VGLI) currently prohibit assignment for value to a viatical settlements company. 38 C.F.R. § 9.6 (1998). However, the Federal Employees' Group Life Insurance Program (FEGLI) allows assignment for value; current regulations for assignment of life insurance proceeds for FEGLI are codified at 5 C.F.R. § 870.901 *et seq.* (1998). These regulations include procedures for assigning life insurance policies and delineate the rights of insured individuals after assignment occurs.

2. DETERMINATION OF LIFE EXPECTANCY

The primary factors affecting the determination of an insured's life expectancy are the ad hoc judgments of the insured's doctors and viatical settlement company's physicians. No actuarial tables for HIV symptoms currently exist. The practitioner should press the insured's physician for a specific life expectancy determination, recognizing that the shorter the term, the higher the price a viatical settlement company will pay. In this regard, a viator's viral load will probably be of greater significance than his CD4 (T-cell) count. To determine eligibility, the insured must release his or her medical records to the viatical settlement company. These records should reflect any current medical conditions that may affect a life expectancy determination. A client's confidentiality concerns related to re-disclosure of those records should be taken into account and addressed by counsel.

3. VIATICAL COMPANY'S COST OF CAPITAL

Viatical companies have different sources of capital. Some operate with a line of credit or commercial loan; other companies pool funds from individual investors. In any event, an individual viatical company may be in a position where it needs to buy more policies to supply investors, or may have limited funds. These differences in viatical companies' costs of capital are illustrated by the large variances in offering prices often encountered by clients who obtain multiple bids. The viator usually should be advised to contact at least three to five viatical settlement companies or to engage the services of a reputable seller-broker. If the client deals directly with the viatical settlement companies, the practitioner may want to handle the final negotiations himself to avoid the situation where a client with a shortened life expectancy must argue that his life expectancy is less than that determined by the viatical settlement company. Finally, be aware of the current marketing trend for viatical settlement companies to offer "value-added services," such as supplying prescription drugs to viators. These are marketing devices designed to make a viatical settlement company more attractive without necessarily paying more cash to the viator.

## F. IMPACT OF VIATICAL SETTLEMENTS

For people living with HIV, receiving cash from a viatical settlement will affect at least three important areas: (1) access to public benefits (relating to both income and medical care); (2) income, estate, and gift taxes; and (3) debt management and planning for a possible bankruptcy filing. Attorneys should make their clients aware of all the potential consequences of a viatical settlement and help them determine whether viatication would be beneficial in light of those issues. If it is not, the practitioner should help the client consider possible alternatives to viatical settlements, described in Section G, beginning on page VI-11.

1. PUBLIC BENEFITS

Public benefits provide an essential lifeline to many Whitman-Walker clients. These services provide cash, food, and medical assistance to people living with HIV and AIDS. Access

to these programs can literally be a matter of life and death for clients. Advocates must be certain of the impact a viatical settlement will have on benefits the client may need in the future as well those benefits the client currently receives. Counsel should review Chapter VII, "Public Benefits," for a discussion of various assistance programs and their eligibility guidelines. In the event that the attorney has any questions regarding the impact of viatical settlements on public entitlements, please contact Whitman-Walker Legal Services for assistance.

a. Non-means-tested programs. Eligibility for some benefit programs such as Social Security Disability Insurance (SSDI) and Medicare are not based on an applicant's income or assets. Eligibility for both SSDI and Medicare is based on employment history; current income and asset criteria are irrelevant. Viatical settlements will have no impact on an applicant's eligibility for either of these programs.

b. Means-tested programs. As a general proposition, the proceeds from viatical settlements will affect the viator's eligibility for means-tested programs. During the month an individual receives the proceeds from a viatical settlement, the amount of the settlement is considered income. *See Arnfeld v. U.S.*, 163 F. Supp. 865 (Ct. Cl. 1958); *Gallun v. Commissioner*, 327 F.2d 809 (7th Cir. 1964). In the following months, unspent balances from a viatical settlement will be considered as an asset. It may be possible for a client to minimize the period of time during which eligibility is lost by using viatical settlement proceeds to prepay known expenses (*e.g.*, rent, mortgage, car loan payments, or other debt).

The potential right to receive money by entering into a viatical settlement is not considered countable income or resources. Similarly, an applicant for or recipient of federal benefit programs cannot be required to enter into a viatical settlement as a condition of eligibility. However, remember that any life insurance policy that can be surrendered for cash will always be counted as an asset (in the amount of the cash surrender value, not the face value) for purposes of any means-tested benefit program.

Among the means-tested programs of concern to people with HIV/AIDS who are deciding whether to access living benefits are Supplemental Security Income (SSI), Medicaid, Temporary Assistance to Needy Families (TANF), and veterans' benefits (medical and pension). Each program calculates income and asset eligibility differently. *See* Chapter VII, "Public Benefits," for details on many of the relevant means-tested programs.

2. TAXES

Section 331 of the Health Insurance Portability and Accountability Act of 1996 (HIPAA) treats the proceeds of certain accelerated death benefits and viatical settlements as an amount paid under the life insurance contract as though the insured had died. In other words, the proceeds of certain transactions are no longer considered taxable income. However, to receive this tax-exempt treatment, a viatical settlement must meet certain stringent requirements. For example, the viatical settlement company involved must be licensed in the state where the viator resides. (If the viator lives in a state that does not require the viatical settlement companies to be

licensed, the company must satisfy the disclosure and general requirements of the Viatical Settlements Model Act of the National Association of Insurance Commissioners (NAIC).)

In addition, to be tax-exempt under § 331, the payment for a viatical settlement must be reasonable, as that term is defined by the NAIC's minimum pricing regulations. For example, the NAIC's Viatical Settlements Model Regulations require that a viator with an 18 to 24-month life expectancy receive 60 percent of the face value of his or her policy. But if prices offered for policies continue their downward trend, this minimum payment requirement may unintentionally disqualify large numbers of viatical settlements from the protections of the Health Insurance Portability and Accountability Act. Counsel should also explore whether the insured individual's policy permits its prepayment if the insured becomes chronically ill; to be tax-exempt under the act, any payment must be used for qualified long-term care services.

The primary tax concerns for recipients of viatical settlements not covered under the 1996 law are federal income tax and estate tax. If they do not qualify under the HIPAA, viatical settlements are treated as proceeds of the sale of life insurance and must be included in calculations of ordinary income. *Arnfeld v. United States*, 163 F. Supp. 865 (Ct. Cl. 1958); *Gallun v. Commissioner*, 327 F.2d 809 (7th Cir. 1964). Only proceeds payable by reason of the insured's death are not included in the beneficiary's gross income. I.R.C. § 101, 26 U.S.C. § 101 (1994). Applicable state tax issues also must be considered, but their impact is relatively minor compared to the potentially severe federal tax liability.

Upon an insured's death, amounts received for a viatical settlement may be included in the decedent's estate for estate tax purposes. If the decedent has assigned or gifted all rights in the policy within three years of his or her death, the viaticated amounts will be considered part of the decedent's gross estate. I.R.C. § 2035(d)(2), 26 U.S.C. § 2035(d)(2) (1994).

There are two key strategies to minimize the taxation of accelerated death benefits and viatical settlements. The first is to schedule the receipt of proceeds in conjunction with an offset to taxable income, such as medical bills. The second is to divide the insurance policy into smaller policies that are accelerated or viaticated over time so that the proceeds flow to the client in more than one taxable year. This strategy may also result in a better return on those portions of the policy that are sold when there is an increasingly shortened period of life expectancy. The practitioner, however, must exercise caution when having a larger policy divided into smaller policies to avoid any new periods of contestability attaching to the smaller policies. Otherwise, the smaller policies will likely not be saleable during that time (*see* Section E.1.b, page VI-6 above).

3. CREDITOR/DEBTOR AND BANKRUPTCY ISSUES

Proceeds from viatical settlements are subject to the claims of creditors. Proceeds from potential viatical settlements, however, are not subject to the claims of creditors. If a client receives viatical settlement proceeds soon before or soon after filing for bankruptcy, those proceeds might be subject to creditors' claims, notwithstanding the bankruptcy. *See* Chapter XI, "Debtor's Rights and Bankruptcy Issues," for a more complete discussion of this topic.

## G. ALTERNATIVES TO VIATICAL SETTLEMENTS

There are several alternatives to viatical settlements which clients and advocates should consider before the client decides to viaticate. Some of these options may help clients avoid the common problems that viatical settlements can create with respect to tax liability, entitlements eligibility, or debt problems. All options should be reviewed thoroughly before pursuing a course of action.

### 1. ACCELERATED DEATH BENEFITS (ADBs)

Many life insurance policies offer policyholders some type of accelerated death benefit in lieu of paying a benefit when the insured dies. The criteria for determining the amount of an ADB are similar to those for viatical settlements (*see* Section B.2, starting on page VI-3). Receiving an ADB has all the same tax, debt and entitlement eligibility impacts as a viatical settlement (described in Section F, beginning on page VI-8). However, the policyholder's insurance company may pay more in ADBs than the viator could receive from a viatical settlement company. ADBs may also be a policyholder's only option if the policy contains significant restraints on assignment, transfer, or viatication. ADBs also may be available if a policyholder requires extraordinary or long-term medical care. The client and advocate should carefully review the policy to determine when and how ADBs can be accessed.

### 2. THIRD-PARTY LOANS

Clients should consider the possibility of obtaining a third-party loan by using the life insurance policy as collateral and the primary method of repayment. In this scenario, a client would contract to receive a cash loan from a third party (generally a friend or relative). In exchange, the third party would become the beneficiary of the life insurance policy.

This approach has some distinct advantages over a viatical settlement. A loan is not considered income for tax purposes. A loan would also not constitute income when evaluating a client's eligibility for public benefits programs.

However, a loan also entails negative considerations. First, third-party loans that are not between friends or relatives generally permit the lender to assign its interest in the policy to another party who may or may not have the liquidity necessary to satisfy future loan requests. Second, loans can be costly. The price for a commercial viatical loan will usually be similar to the price of a viatical settlement, plus a significant loan origination fee. Third, if the loan is "friendly," the insured would need to locate a third party willing to enter into such an agreement (as noted above, usually a friend or relative). Fourth, although a loan is not considered income for public benefits purposes, the proceeds will be considered as an asset. Finally, creditors may attach unspent loan proceeds.

3. PARTIAL VIATICATION

A client might benefit from splitting a single policy into smaller policies to be sold over a period of time, especially if the face amount is $100,000 or more. This method has significant tax advantages and also should result in greater returns on those portions of the policy sold when life expectancy may be shorter. However, as mentioned above, the client and advocate must use extreme caution when dividing a policy to avoid subjecting the insured to any new underwriting problems such as periods of contestability regarding the smaller policies. See Section E.1.b, page VI-6 and Chapter IV, "Insurance and Employee Benefits."

**Written Statement of**

**GLORIA GRENING WOLK**
**CONSUMER ADVOCATE AND VIATICAL EXPERT[1]**

**To be Included in the Hearing Record of**

**The Subcommittee on Oversight and Investigations**

**Committee on Financial Services**

**"Retirement Protection: Fighting Fraud in the Sale of Death"**

**February 26, 2002**

Although I am unable at this time to accept the invitation to testify on this "hot issue," I am greatly relieved that Congress is, at last, taking notice of viatical fraud and the tragedy it has brought to tens of thousands of retirees. Viatical fraud is unlike most other types of fraud. Although the numbers are not as great as with Enron, the continuing vacuum of regulation combined with the complexity of this investment may well result in as many victims as Enron.

Viatical and Life Settlement investments, appropriately dubbed "Death Sales," are an industry that will not go away. The industry has existed for slightly more than ten years, claims annual revenues in the billions, and operates not only in every one of fifty states but has spread to all continents except Africa.

As to claims of billions in revenue, there is no way to know if these numbers are bloated since the lack of regulation means there are no reporting requirements. This is the reason why we also do not know how many people are victims of viatical fraud. We know by name

[1] Internationally recognized as a consumer advocate and expert, Wolk was invited speaker at conferences of NASAA, NAIC, NCOIL, was featured in articles by Jane Bryant Quinn (Washington Post and Newsweek) and Kathy Kristof (Los Angeles Times syndicate); and was the source for information and referrals for personal stories for Kiplinger's Retirement Report, Kiplinger's Personal Finance, TIME, Forbes, Newsweek, Washington Post, The Wall Street Journal, and others. The author of two consumer books on viatical settlements, Wolk began to expose viatical fraud in February 1998, with the consumer information website www.Viatical-Expert.net. Her effectiveness led to four SLAPP suits filed against her by companies that represent the underbelly of the industry. To date, Wolk has prevented upwards of $2 million from going out of the pockets of naïve investors and into the pockets of scam artists.

approximately ten thousands victims who were identified through investigations of certain companies by the FBI and the Postal Service. The Department of Justice has indicted some of the perpetrators; a few are in jail, but there are many others who continue to operate, undeterred by any law enforcement agency.

Following are some of the new types of fraud related to this complex and sophisticated investment:

- **Cleansheeting**: a terminally ill person applies for new insurance and falsely claims to be in perfect health, then sells this fraudulently obtained policy. Many of these have been cancelled by insurers, leaving investors with nothing.

- **Wet ink**: a healthy person, usually of senior age, applies for new insurance ostensibly for estate planning purposes but actually with the intent of selling the policy immediately. Insurers also may cancel these fraudulently obtained.

- **Life expectancy fraud**: Viatical companies falsely inform investors that the insured is much sicker and thus has a shorter life expectancy than medical records indicate.

- **Life expectancy fraud**: The policy insures a healthy person who submitted false medical reports that indicate terminal illness.

- **Ponzi scam**: False documents provided to investors but no life insurance policies were purchased by the company; earlier investors are paid "profits" from new investors' funds.

- **Misrepresentations**. For details, see chapter 2, "Viatical Settlements: An Investor's Guide" by Gloria Grening Wolk, Bialkin Books, 1998.

## FEDERAL ISSUES THAT NEED FEDERAL ACTION

Although not all problems with this industry can be addressed on the federal level, there are four key areas that need immediate action by Congress:

**Retirement: IRA accounts**

- Most defrauded investors are retirees; many used their IRAs for this investment
- Life insurance is prohibited as an investment for IRAs, but sales agents falsely claim that it is "approved."
- Most IRA trustees do not accept viatical settlement contracts as investments for self-directed IRAs, but four do -- thereby lending credence to the false claim that this is an acceptable investment.
- The injury of learning that their investment is worth less than a roll of toilet paper is compounded when the Internal Revenue Service duns retirees for taxes on funds they will never again see, and interest on the unpaid tax, and penalties.

- Some retirees were forced to sell their homes in order to pay the taxes and have some cash with which to supplement social security.
- Some employees who are nearing retirement convert their 401(k) to IRAs in order to invest in viatical and life settlements contracts.

**REMEDY**: Hold IRA trustees accountable for their role in fraudulent schemes. Require IRS to publicize more widely and more often that no investments are approved for IRAs. This would not have any fiscal impact.

**Tax Law**

- Investors may be told that profits from this investment are tax-free. Although death benefits of life insurance generally are tax free to beneficiaries, one exception is when the policy is "transferred for value."
- Tax is levied from the day funds were withdrawn from traditional investments.

**REMEDY**: Waive all penalties, interest, and taxes due on IRAs belonging to retirees who were defrauded of these funds, upon presentation of proof of fraud and hardship. Also, require IRS to publicize that such hardship waivers are available to retirees. This would not have any fiscal impact

**Bankruptcy Law**

- A bankruptcy trustee wants to force a 67-year-old man who suffers from Parkinson's Disease to sell his term life insurance policy in order to have more cash for creditors
- Not only does this place the debtor at risk of homicide when the premiums shoot up astronomically, but such a sale would deny benefits available to a seriously ill insured by many insurance companies.
- Such a sale might also violate the insured's privacy rights, since several courts have ruled that once the policy is sold it is a business transaction, thereby negating any laws that protect privacy and confidentiality of medical information. Some viatical companies actually use the medical information as marketing materials, when they solicit investors.
- It is ironic that bankruptcy *protection* is now being used to place the debtor and his family at greater risk.

**REMEDY:** Add to bankruptcy legislation a prohibition against ordering any debtor to sell his/her life insurance. This would not have any fiscal impact.

**Securities Law**

- The complete lack of regulation is due to a widely criticized opinion of the D.C. Court of Appeals 1996, which rejected the SEC's bid to regulate viatical investments. The ruling included the opinion that this investment was neither a security nor an insurance product.
- That ruling was contradicted in detailed rulings by two other district courts and a number of state courts.
- The absence of regulation is the main reason viatical fraud has a growth rate akin to that of rabbits.
- The ever-increasing numbers of victims is directly attributable to the lack of regulation.

- When challenged in court, viatical companies that profit from fraud claim as their defense the 1996 decision. As a result, every government or civil attorney must fight this battle anew.
- Eventually, these conflicting rulings will bring the issue before the U.S. Supreme Court, thus costing many taxpayers dollars to accomplish what may be done far more simply and inexpensively if Congress mandated that this investment should fall under the jurisdiction of the Securities and Exchange Commission. Moreover, this would empower state agencies and give some direction to consumer law attorneys, elder law attorneys, etc.

**REMEDY:** Congressional action that defines viatical and life settlement investments as securities. No fiscal impact.

Note: There have been few civil suits on behalf of victims. Most victims do not file complaints with regulatory agencies. Attached is a letter from one person who did try to get government agencies to help her, without success. This letter from an 84 years old widow is typical of the victims of viatical fraud.

I welcome your interest in this critical issue and will be glad to provide you with any information that is within my power.

Gloria Grening Wolk
Consumer Advocate and Author
25381 Alicia Pkwy. # G336
Laguna Hills, CA 92653
949.249.5444

Ms. Wolk --

I am answering questions that you asked in your last email. Now I am a permanent resident of FL. I live in Clearwater Fl. I invested $10,000 in ABC Inc. through my broker which was in PA. At the time I knew him for quite a while. He worked for the Local Bank when he first started then he went into business for himself, had an office in Media, PA and worked out of his home in Westchester, PA.

Mr. Averill came out to my home shortly after I sold my home; he asked me what I was going to do with all my money from the house. I answered that I needed a new car (my other one was 11 yrs. old) and I planned on buying another condo, a little larger. I have a very very small condo, which is so uncomfortable as I was used to a large home all my life. Well, I never got my larger condo. I did get another car.

Well Bill Averill said you do not put all your money in bank you should invest to make money on your money; he preceded to show me the folder with ...(ABC) "Viatical" said I could not go wrong and it paid a good percent of interest. Me, not knowing a thing about viatical or no one else understands how it works I thought, at the time it looked good so I agreed to invest with ABC. Since, I had invested money for income from Averill and it seems to work. In fact he would come out to my home at the end of the year and review the investments to see if I was making

anything. I even had his phone no. and knew where he lived. I never got any reports from ABC other than the initial information, in fact I did not pay too much attention to it, just expecting to get a check plus interest some day; until the FL State Commissioner in Tallahasee wrote me a letter stating they revoked ABC's license in February. I did not receive anything since.

I contacted them several times and they were nice and talked to me at first. Cheryl seemed to know the answers and how it works. The last time I called she said she could not talk to me it was out of her hands and to get an attorney.

I am an old lady 83 yrs. of age and live alone very lonesome and in very very poor health. The way I feel now it will not be too long that I will need help myself. I had 2 strokes already which has affected my voice. I am having trouble talking, have a bad heart, on many medications which are costly. I have to get a blood test every month since I take coumadin (a blood thinner). I am off balance often, have very bad feet (neuropathy, meaning nerve endings ache all the time). My feet are numb, burn, itch and ache all the time. I find that I can hardly walk. Worst of all my eyes are getting very bad as you will notice, hard to stay on the line. Eye Dr. tells me I am getting Macular Degeneration (which means that I will not have sight one of these days). This seems to be progressing quite rapidly now. In addition to all the health problems I have pre-skin cancer from early sun. I have spots, lumps, etc. cut out quite often and have constant burning and itching. I have much trouble sleeping at night since I had the stroke which is very exhausting.

I have looked up addresses, phone nos. etc. and written to everyone but the president of U.S. and get the same story, they simply push it on to someone else. I even called and talked to the FBI in Tampa, Orlando, and Clearwater, called consumers' protection, State securities (both FL & PA), Channel 8.

You asked in your note (Email) was my broker licensed. I really do not know. I thought he was as some of my investments come through after his name "Broker." I called Oppenheimer to see what brokerage firm he was employed with, I find "Atlas Brokerage Co." in Washington, PA. I talked to the president Mr. Bryant Fisher, he tells me he has not been with them for 2 yrs. now. I wrote Averill a nice letter and begged him to call me, which I made at least 6 long distance calls, his phone rings but the answering machine comes on (it is his voice). I even talked to the little boy one afternoon. He said he remembered me since I always sent candy at Xmas. He took my phone no. and name but never an answer. I even had Joe Sloan (215-665-1180) NASD Regulations 1835- Market St. 19 FL, Phila. PA 79103.

Many, many thanks for all your concern, I do hope that you can help.

Sincerely,

Rita G. Moore