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**Testimony of**
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**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.