

**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.”

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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 policies, 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.