SEC Charges Life Settlements Firm and Three Executives with Disclosure and Accounting Fraud

FOR IMMEDIATE RELEASE
2012-2

Washington, D.C., Jan. 3, 2012 — The Securities and Exchange Commission today charged Texas-based financial services firm Life Partners Holdings Inc. and three of its senior executives for their involvement in a fraudulent disclosure and accounting scheme involving life settlements.

The SEC alleges that Life Partners chairman and CEO Brian Pardo, president and general counsel Scott Peden, and chief financial officer David Martin misled shareholders by failing to disclose a significant risk to Life Partners' business: the company was systematically and materially underestimating the life expectancy estimates it used to price transactions. Life expectancy estimates are a critical factor impacting the company's revenues and profit margins as well as the company's ability to generate profits for its shareholders.

The SEC alleges that Life Partners and the three executives were involved in disclosure violations and improper accounting that Life Partners used to overvalue assets held on the company's books and create the appearance of a steady stream of earnings from brokering life settlement transactions. The SEC further charged Pardo and Peden with insider trading in their shares of Life Partners stock while in possession of material, non-public information indicating that the company had systematically and materially underestimated life expectancy estimates.

"Life Partners duped its shareholders by employing an unqualified medical doctor to assign baseless life expectancy estimates to the underlying insurance policies," said Robert Khuzami, Director of the SEC's Division of Enforcement. "This deception misled shareholders into thinking that the company's revenue model was sustainable when in fact it was illusory."

David Woodcock, Director of the SEC's Fort Worth Regional Office, added, "The senior-most executives at Life Partners concealed significant risks to the business, manipulated financial statements with improper accounting, and knowingly profited from their misconduct by executing insider trades based on information that was not available to the public."

Life Partners is a Nasdaq-traded company that generates virtually all of its revenues from brokering life settlements. Life settlements involve the purchase and sale of fractional interests of life insurance policies in the secondary market. In life settlement transactions, life insurance policy owners sell their policies to investors in exchange for a lump-sum payment. The dollar amount offered by the investor takes into account the insured's life expectancy and the terms and conditions of the insurance policy.

According to the SEC's complaint filed in federal district court in Waco, Texas, Life Partners misrepresented and failed to disclose in public filings with the SEC that the company's systematic use of materially underestimated life expectancy estimates constituted a material risk to the company's revenues. Beginning in 1999, the company used life expectancy estimates provided by Dr. Donald T. Cassidy, a Reno, Nev.-based doctor with no actuarial training or prior experience rendering life expectancy estimates. The SEC alleges that Life Partners and Pardo failed to conduct any meaningful due diligence on Cassidy's qualification to act as a life expectancy underwriter and instructed the doctor to use a life expectancy methodology that was created by the company's former underwriter, a part-owner of Life Partners. Pardo, Peden, and Martin were aware that the Cassidy-rendered life expectancy estimates were systematically and materially short.

The SEC alleges that Life Partners materially misstated net income from fiscal year 2007 through the third quarter of fiscal year 2011 by prematurely recognizing revenues and understating impairment expense related to its investments in life settlements. Life Partners improperly accelerated revenue recognition from the closing date to the date it obtained a non-binding agreement with the policy owner to sell a life settlement. Life Partners use of Cassidy's life expectancy estimates as part of its impairment calculations caused the company to understate millions of dollars in impairment expense.

The SEC further alleges that during this time, Pardo and Peden sold approximately $11.5 million and $300,000 respectively of Life Partners stock at inflated prices while in possession of material non-public information about the company's dependency on short life expectancy estimates to generate revenues.

In addition to the alleged violations of the antifraud and reporting provisions of the federal securities laws by Life Partners, Pardo, Peden and Martin, the SEC's complaint also seeks repayment to the company of stock sales profits and bonuses received by Pardo and Martin pursuant to Section 304 of the Sarbanes Oxley Act of 2002.

The SEC's investigation is continuing.

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Related Materials

- SEC Complaint