

Statutory Accounting Fraud Under RICO

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Echoing New York's regulatory criticism concerning the use of captive reinsurers and similar allegations in recent class actions filed against several New York life insurers, an annuity contract owner has filed a putative nationwide class complaint against Fidelity & Guarantee Life Insurance Company (F&G), its indirect parent, Harbinger Group, Inc., and two affiliates based on allegations of statutory accounting fraud. Unlike the other cases, which asserted violations of New York insurance law, plaintiffs are pursuing their claims under the Racketeer Influenced and Corrupt Organization Act (RICO), 18 U.S.C. § 1961 *et seq.* The crux of the complaint, in *Ludwick v. Harbinger Group, Inc.* (filed in federal court in Missouri), is that, shortly after being acquired by Harbinger, F&G used non-economic, "sham" reinsurance transactions to offload billions of dollars in liabilities to recently formed captive reinsurers and Wilton Re, an independent reinsurer not named as a defendant. These transactions and practices allegedly permitted F&G to misstate its surplus and risk-based capital ratio to, among others, regulators and ratings agencies. Plaintiff claims that, on the purchase date, she and fellow F&G annuity purchasers suffered an immediate loss in the form of the "diminished value" of their annuities due to the alleged "undisclosed adverse financial condition and default risk" as well as supposedly lower interest and index credits. The complaint faces significant legal hurdles. For example, **many courts have found that similar diminution-in-value injury theories do not constitute "injury to business or property" under RICO because, *inter alia*, increased default risk is a speculative injury.** And the lawsuit appears to invade a core area of state insurance regulation—the financial condition of life insurers—which the defendants have argued warrants dismissal under the McCarran-Ferguson Act. If the complaint survives dismissal, plaintiff also will face obstacles demonstrating class-wide reliance as most courts have found that reliance is a necessary element of causation under 18 U.S.C. § 1964(c) in civil RICO claims alleging fraudulent inducement. One paragraph of the complaint claims that the "price" of the annuities was inflated by the alleged fraud, suggesting that plaintiffs will argue in the alternative a "fraud-on-the-market" causation theory similar to that employed in federal securities law cases.

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