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Clearing Up Common Misconceptions About Life Settlements

By **Eileen Shovlin**

Life settlements provide producers with a very new way to help older life insurance clients make strategic use of their life policies.

Even so, some marketers confuse life settlements with viatical settlements. It is true that both types of transactions entail the purchase of an existing life policy, with the proceeds of the sale going to the policy owner. However, the two transactions differ in critically important ways.

Here are some facts to help clear the airand also to help you decide when to consider the life settlement option for your clients.

First and foremost, a life settlement is different from a viatical settlement.

The life settlement is a sophisticated financial planning tool for older affluent individuals. It is generally for insureds over age 65, with a life expectancy of 13 years or less, who have had a change in health but are not terminally ill.

The face amounts of the life policies used in these agreements tend to be large. (At our firm, they average $1.1 million, with many going over $10 million.) Currently, seven institutional buyers finance life settlements.

A viatical settlement, on the other hand, is purchased when the insured has a life expectancy of generally two years or less (specific regulations vary by state).

Typically, viatical settlement transactions are on the small side, generally involving face amounts of $50,000 or so. A viatical settlement often relies on an individual investor for financing, and often times the investor knows the identity of the insured and the policy owner.

Here are some other life settlements pointers:

1) A life settlement is not considered a security, according to most states "blue sky" security opinions.

In these opinions, there is a distinction between the "front end" and the "back end" of a settlement.

It goes this way: If a policy owner sells a policy to a licensed settlement provider and the transaction has been consummated in accordance with the states viatical and life settlement laws and regulations (the "front end"), the client and his insurance advisor have not participated in a transaction regulated as a security.

If, however, an insurance advisor is raising funds for financing entities or reselling purchased policies to individual investors (the "back end") this, according to most states, *would* constitute a security.

2) Life settlements can be helpful to life insurance carriers.

Life settlements will help the insurance industry by adding greater value to life insurance. As consumers receive additional value, over time this may be an additional reason for people to purchase life insurance.

In addition, life settlement companies are the only entities that re-underwrite policies (after the two-year contestable period) in order to consider a policy for purchase. In doing so, life settlement companies may discover agents who knowingly participate in fraudulently obtaining life policies.

As settlement companies report these agents to the proper state authorities or the carrier, this information will enable the carriers to weed out agents who generate bad business. The result will be

Life Settlement Profile

- Producers use life settlements as a sophisticated planning tool.
- The target market is affluent people, over age 65.
- The insured has a life expectancy of 13 years or less, but is not terminally ill.
- The insured's health has declined since issue of the life policy.
- The average face amount of the purchased policy is large, easily $1 million or more.
- Life settlement financing typically comes from institutional buyers.

better mortality experience and greater profits.

3) Agents and broker-dealers may have a responsibility to present life settlements as an option.

There could be a fiduciary responsibility for insurance agents, trust officers and advisors when the option to surrender a policy for cash value may be less beneficial than the option to sell the policy for more than cash value.

At least one well-known attorney has already raised the question in a public venue. In a recent column in *Journal of Financial Planning,* Los Angeles attorney Jon Gallo, co-chair of the Life Insurance Committee of the Real Property, Probate and Trust Law section of the American Bar Association and a prominent Los Angeles attorney, put it this way:

"What is the liability of the trustee of an insurance trust who allows a thinly funded policy to lapse if the policy had a value in the after-market? And what is our liability for failing to tell the trustee and the insured about the after-market?"

4) A life settlement presents an excellent opportunity for life insurance advisors.

Over 20% of all insureds age 65 or older have policies worth more than the cash surrender value due to a decline in health. More and more insurance advisors have become aware of the opportunity this creates for their clients and their practice.

A life settlement can generate substantial fees and create valuable exposure to trustees, attorneys, accountants and other financial planners active in the older, affluent markets.

In addition, two out of five life settlements result in a new life, annuity, or other investment sale. NU

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