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By HOLMAN W. JENKINS, JR.



Life Insurers Face the Future, Grudgingly

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Fate continues to shower blessings on the greatest generation. Elderly Americans may soon be able to supplement their incomes by collecting fees from investors who wish to bet on their life expectancy. That, at least, is the fear of the life insurance industry, still wondering how to get the "viatical" genie back into the bottle.

Faithful readers will recall that ginned-up Latin nomenclature applied to deals in which investors would take over the life insurance premiums of terminally sick patients (frequently AIDS patients) and collect the death benefits when they died. Happily for one party to these deals, many of the patients are still alive, thanks to new drugs. Not so happily, some investors feel cheated, and sometimes were.


But the principle had been established. A life insurance policy is the property of the insuree, and he or she can sell it to somebody else.

Lo, by the time of our second column on the subject, the business had given itself a new name, "life settlements." It now was geared toward buying high-value policies from older folks who might have had a health reverse but still had several years of life expectancy remaining. German investors were particularly keen thanks to favorable tax laws. At last count, more than 20 German funds have been set up to invest in the death benefits of Americans. Warren Buffett's Berkshire Hathaway and insurance giant AIG also dabbled in the business.

With more than \$9 trillion of life insurance in force, Sanford C. Bernstein & Co. estimated last year that the market for "used" policies already topped \$13 billion and it could hit \$160 billion by 2030, depending on whether Congress kills the estate tax (the motive for many purchases of high-dollar life insurance) and other boomer financial considerations.

All along the insurance industry has been disgruntled about this new marketplace. One good reason was a suspicion that a few people buying insurance were hiding illness to get coverage, then flipping the policy to an investor for a sizeable payment. Fraud aside, though, the industry also worried about its "lapse" assumptions.

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Mr. Jenkins joined the Journal in May 1992 as a writer for the editorial page in New York. In February 1994, he moved to Hong Kong as editor of The Asian Wall Street Journal's editorial page. He returned to the domestic Journal in December 1995 as a member of the paper's editorial board and was based in San Francisco. In April 1997, he returned to the Journal's New York office. Mr. Jenkins won a 1997 Gerald Loeb Award for distinguished business and financial coverage.

Born in Philadelphia, Mr. Jenkins received a bachelor's degree from Hobart and William Smith Colleges in Geneva, N.Y. He received a master's degree in journalism from Northwestern University in Evanston, Ill., and studied at the University of Michigan on a journalism fellowship.

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Life insurance has long been priced on the belief that a sizeable share of policies would be allowed to lapse because the customer could no longer afford the premiums or no longer needed the coverage. If such policies are instead kept in force by outside investors, well, oops. CEO Johnny Johns of Protective Life Corp. likens it to finding termites in your basement and hoping it's only a few termites. His firm no longer sells certain high-dollar policies to the over-75 crowd. "That's the zone where there's the most danger," he told investors in March.

Some insurers still daydream about Congress using the tax code to stamp out secondary trading in life policies. Obliging, New York state regulators recently issued an "opinion" making it illegal for investors to offer upfront fees or rebates to customers willing to take out policies for the purpose of reselling them. It's unclear, however, whether the New York ruling would survive challenge under settled law assuring policy owners a property right in their policies.

Life insurers and their trade groups recently opened a second front, asking state insurance commissioners to redraft their "model law" to ban "investor-initiated" life insurance. But not even this idea commands majority support in the industry, where some insurers worry it would undermine a thriving existing business of using loans to help qualified clients buy large-value policies.

At an investor conference in December, AIG's David Herzog played the skunk: "This is a capital markets, free market society that we live in. . . . If other entrepreneurs come in and find a weakness in our pricing, that is not their fault; that is our fault."

His unwelcome peroration may be the industry's best roadmap to surviving the future.

You can't venture deeply into this debate without hearing solemn reference to "insurable interest" (the principle that a beneficiary should have a stake in the well-being of the insured). In the next breath usually comes a nod to the holy of holies, Britain's Gambling Act of 1774 (which made betting on the lives of strangers illegal).

All this reverence is touching, but also a red herring. Life settlements today are being packaged into securities and sold to institutional investors. They're held on the books of reputable firms and even offered as traded funds for small investors. A.M. Best, the insurance rating agency, has even come out with best-practices guidelines for packaging life insurance policies into bonds: make sure no single life represents more than 3.33% of the value; make sure many diseases are represented so a miracle cure for one won't devastate bond holders.

The industry's "insurable interest" scruples, at bottom, grew out of fear of insurance policies being written at the behest of homicidal beneficiaries who planned to hasten their payoff. That concern is nullified as the business has become institutionalized. The stark residual is the industry's displeasure at having its pockets picked by those exploiting its reliance on lapsed-based pricing and, perhaps as well, exploiting its failure adequately to check on the medical histories of applicants.

Insurers may wish the problem would go away, but it won't, leaving them only the choice to tighten up their underwriting. But they can at least applaud themselves for casting enough doubt on the life settlements industry that, so far, their existing book of business has not gone belly-up. Insurers may soon begin to notice a happier ending, in which the existence of a secondary market actually makes life insurance a more attractive product.

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