The Secondary Market for Life Insurance is Poised to go Mainstream – Are You Ready?

by Constance M. Buerger

Paradigm shifts don't occur overnight. Yet, somewhere along the line, there comes a convergence of factors that makes significant change inevitable. With regard to the secondary market for life insurance, this "tipping point" may already be in the rear-view mirror.

In the past few years, the secondary market for life insurance has exploded onto the financial planning scene. Clearly, the market's basic premise — the consumer's right to resell unwanted or unneeded life insurance — has been validated by the U.S. market's spectacular growth, which is expected to exceed $45 billion in face value by 2007. More importantly, the market and its associated products, such as life settlements, are attracting significant attention from professionals outside of the life insurance industry.

Consider the estate planning community. A recent article titled "The Benefit of a Secondary Market for Life Insurance," in the *Real Property, Probate & Trust Journal* of the American Bar Association concludes that the secondary market for life insurance is both pro-competitive and pro-consumer. By allowing companies to compete for unwanted or unneeded policies, the secondary market has generated greater consumer choice, a wider range of products and favorable valuations for consumers. But the implications don't end there. The article goes on to suggest that the market will enhance the perceived value of life insurance, leading to an expansion of the industry as a whole. It concludes by suggesting that lawmakers design regulations to "encourage participation and investment in this secondary market."

Such regulation is indeed happening.

A number of states are in the process of passing provisions that protect the consumer's right to know about the opportunities available in the secondary market. It's likely that California will be moving forward with legislation in the coming year. These moves are sending a clear message to financial advisors that secondary market offerings are now within the limits of their fiduciary responsibility. "What is the liability of the trustee...who allows a thinly funded policy to lapse if the policy had a value in the aftermarket?" asks Jon J. Gallo, JD, co-chairman of the Life Insurance Committee of the Real Property, Probate & Trust Law Section of the American Bar Association.

It's a question that Paul F. Kirsch posed in the March 2003 issue of *California Broker* Magazine in his article, "Will History Repeat Itself?" He noted that a failure to disclose the material benefits of life settlements to clients could open the door to a new wave of consumer-based litigation. The implications of these new responsibilities are a major factor driving advisors to demand to be educated about secondary market transactions.

The other factor is the sheer magnitude of the opportunity. In the U.S. alone, there is more than $100 billion of life insurance in effect where the market value exceeds surrender value. On a more immediate level, the secondary market presents a rare opportunity to bring new and significant value to clients. Considering that life settlements invariably lead to additional transactions including annuities, new life insurance, or investments, it's a tremendous new business opportunity for producers.

Not surprisingly, the situation has attracted the attention of the capital markets. High-quality institutional capital is pouring into the secondary market — the importance of which cannot be overstated. Not only does institutional backing provide a secure funding source for secondary market transactions, it also provides the highest degree of consumer protection with regard to privacy and confidentiality, as well as a solid foundation on which the industry can grow.

So, it should come as no surprise that advisors throughout the financial services industry are demanding the tools and information they need to educate their clients about the secondary market opportunities. The interest extends to other professional arenas including wire houses, tax attorneys, trust officers, accountants, financial planners, and registered investment advisors.

This raises what is perhaps the most important signal of the market's arrival: carriers are now responding to producer demands with information about life settlements, along with the tools to educate clients.

But, simple economics provide the most tangible account of the market's momentum. Does this mean that life settlements and other secondary market transactions will be popping up on every street corner? Of course not. For the majority of policyowners, maintaining their policy will continue to be the best course. But the mere presence of the market gives them the means to evaluate what the policy is worth in empirical terms. This is likely the most important implication of the secondary market. Life insurance is now more than a tool for risk-management. It has become an asset with significant value that should be appraised and considered alongside one's real estate, businesses, or equities. In cases where the policy is no longer performing up to expectations, the market provides new options. Options that are bringing long-term benefits to every sector of the life insurance industry.

Clearly, it's a time for enormous excitement. But it's also a time for action — for advisors to embrace the opportunities and responsibilities presented by the secondary market. Life insurance is now more flexible, more powerful, and more valuable for consumers and the professionals who serve them. Insurance is indeed being redefined. The tipping point has come and gone. And things will never be the same. ❑

Big Bang

The secondary market is here, as evidenced by its impressive growth...

$100 Billion
Face value of the U.S. secondary market for life insurance at maturity.

$45 Billion
Face value of the U.S. secondary market by 2007

$3.5 Billion
Total dollars to consumers over cash value via U.S. secondary market transactions by 2007.

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