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Helping Clients Understand the Life Settlement Industry

By LARRY SIMON

Life settlements have become increasingly popular with seniors, who often use the cash proceeds as a means of funding annuities or other investments, supplemental retirement income, or new options in estate planning or planned giving, which may better suit their financial goals.

As clients pursue alternative solutions to long term financial and health care needs, agents and brokers will be faced with questions regarding life settlements. Life settlement brokers and agents should understand this emerging segment of the industry, including history, terminology, and the legal framework in which it conducts business.

History of the industry

Life settlements entered the market fairly recently, having evolved from an older business involving "viatical" settlements. The viatical business began in Europe in the 1880s. The United States did not venture into viaticals until the 1980s, when the business developed primarily in response to the AIDS epidemic. Individuals who had the virus often found themselves in difficult financial straits, facing expensive medication and treatment costs. This led resourceful individuals to discover a valuable asset — a life insurance policy with a death benefit that could possibly be realized in a short time.

The beginning of the viatical industry seemed bright. Investors helped those in need by providing them with the capital to pay for medical treatments, while at the same time making a sizeable return on their investment. It wasn't long, however, before unscrupulous individuals realized this was an unregulated market, and it became riddled with fraud. In addition, bad feelings arose over the viatical industry's perceived role as investors in the demise of terminally ill people.

The history of life settlements is relatively new, with the market emerging in the U.S. in the late 1990s. Enterprising life settlement companies realized billions of dollars in policies had lapsed or were surrendered because the insureds no longer needed or wanted policies. Concurrently, life settlements evolved as viable investments, attracting institutional investors. These institutions invest in life settlements using groups of policies to create funds, which create returns based on the law of large numbers.

How life settlements differ from viaticals

Visit the Viatical and Life Settlements Association of America online (www.viatical.org) and you will find a state-by-state breakdown of definitions for the terms "viatical" and "life settlement." However, as you read each state's laws and regulations regarding viaticals and life settlements, you may notice that these terms are not used consistently.

Separate from legal definitions in various states, business practice has developed so that industry participants commonly use the terms "viatical" and "life settlement" in distinctly different ways in the normal course of business. The industry use of these words differs in two respects: insured eligibility and policy characteristics.

Under common business usage, a "viatical" is the sale of a life insurance policy that insures the life of an individual who is terminally ill, has a life expectancy of less than two years, or suffers from a catastrophic medical

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condition. The sale of the policy helps pay the costs of medication and treatment or living expenses for people who can no longer work. The seller can be any age, and policy death benefits are often in the $100,000 to $250,000 range.

By contrast, in a life settlement (also known as "senior settlement" or "high-net-worth transaction"), the insured may be in moderate or even good health. Life settlements often function as financial planning rather than financial assistance, which is more common with viaticals.

The average life settlement candidate is approximately age 78 to 80, has a life expectancy of four to eight years, and generally does not need money from the sale of insurance to pay for medical expenses. Unlike viaticals, life settlements are based on the proposition that some insured individuals no longer need or want coverage. The reasons for selling policies are varied, such as:

- The policy was purchased for a need that no longer exists
- The beneficiaries are either deceased or financially independent
- Another type of investment would be more advantageous
- A change in tax laws or a reduction in estate size makes the policy coverage unnecessary
- The premiums are no longer affordable

Regulation of the life settlement industry

Currently, 38 states regulate viaticals or life settlements. In these states, the settlement providers and agents or brokers representing policy owners in settlement transactions may be required to hold viatical or life settlement licenses to conduct business. Unfortunately, according to a June 2005 report issued by Bernstein Research, "The lack of licensing in other states does not prevent life settlements from taking place." Consequently, agents and brokers should solicit bids only from experienced and ethical life settlement providers, licensed, or otherwise qualified to do business in the policyholder's state of residence. State-by-state regulations can be found on the VLSAA Web site (www.viatical.org).

Larry Simon is director, chief executive officer, and president of Life Settlement Solutions Inc., based in San Diego. Life Settlement Solutions and its management have an established, proven industry record, having purchased life insurance policies of more than $1 billion aggregate face value to date. For further information regarding Life Settlement Solutions, call 858-576-8067 or visit www.lss-corp.com.

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