How to Avoid the Pitfalls of Life Settlements

by Larry Simon

Many financial advisors are aware of the benefits of life settlements, but are not sure how to enter this rapidly emerging and heavily regulated market. The right settlement company can help you maneuver through a myriad of rules and regulations that vary from state to state while providing additional protection against regulatory issues, bad business practices, and fraudulent activities. Working with a trustworthy life settlement company could also give you access to larger distribution networks and more business opportunities

The life-settlement industry has seen tremendous growth over the past few years, given financial professionals more reasons to enter the market. The life-settlement industry reached approximately $12 billion in face value of policies transacted in 2006, according to the Life Insurance Settlement Association (LISA). The most recent Bernstein report reveals that the market is expected to reach $161 billion over the next several years, which is sooner than original estimates.

Financial professionals who work with senior clients may be hesitant to offer life settlements because of what they have heard about the viatical settlement industry and regulatory attention on life settlements. They may also lack of education about the market.

To understand life settlements, it is important to know their history. The life-settlement industry came from the concept of viatical settlements, which developed in response to the emerging AIDS epidemic in the 1980s. Viatical settlements offered a way to use a portion of a life insurance policy's face value for medical bills and other expenses. But, for a number of years, many insurance policies have already contained clauses allowing for the advanced payment of most of the death benefit if an insured became terminally ill. Viaticals attracted investment scams and fraud due to the lack of industry regulation. Since viatical settlements became associated with unscrupulous business behavior, most insurance industry professionals have since rejected them.

Life settlements are different from viaticals, beginning with the type of people they target. While viatical settlements focused on clients with fewer than two years to live, life settlements target people with life expectancies between two and 17 years. Since their appearance in the mid 1990s, life settlements have offered a financial opportunity for senior clients who don't have chronic or catastrophic illnesses. The following guidelines present other ways in which eligibility is determined for a life settlement:

- The minimum age is 65 or older. It is typically 75 or older for females and 72 or older for men.
- The policy is beyond any carrier or statutory contestability period, is fully renewable, and is subject only to the payment of premiums.
- The insured's life expectancy is more than two years, based on medical evaluations from an approved life expectancy underwriter.
- Minimum aggregate face value of the policy is $250,000.

Regulatory attention is increasing for life settlements, particularly with stranger originated life insurance (SOLI) programs. Nonrecourse premium lending programs are used to finance new life insurance solely to make transactions in the settlement market shortly after issue. It is important to separate SOLI transactions from the mainstream life settlement industry. Life settlement associations and many other major industry players have taken a stand to curtail these abusive programs while developing the life settlement industry.

Financial professionals should monitor regulatory developments in the states where they do business and become familiar with licensing requirements that are applicable to them and other financial professionals and settlement providers with whom they work. Many settlement firms and industry associations explain licensing on their Websites.

Life settlements are typically regulated by the state departments of insurance. Thirty-nine states have adopted some regulations for financial professionals, including settlement providers. In addition, the National Association of Insurance Commissioners (NAIC) Viatical Settlements Model Act was introduced in 1993. The Model Act provides guidance on the definition of a life settlement. It contains clauses protecting against fraud and gives states some direction on addressing the sale of life insurance policies to investors. The NAIC has recently adopted a number of amendments to the Model Act designed to curb abusive SOLI programs.

One of the most effective ways to avoid negative business situations is to choose the right life-settlement companies. You can start by gathering information from numerous competitive companies to see which have the most experience and the best resources to make optimal partners.

Since experience is imperative in the life-settlement market, work with companies that have at least $1 billion in purchased aggregate face value to date. Look for firms with excellent senior management teams.

Once you have this information, determine which companies have ethical guidelines, have an understanding of industry regulations, and abide by their state laws. Your state attorneys general office or state insurance department can help you avoid firms that have a history of customer, regulatory, or legal issues.

Choose a life settlement company that is funded institutionally and does not sell contracts to individual or private investors. This way, you will face fewer issues with the funding aspect of selling in the secondary market and your clients privacy will be protected in accordance with regulatory standards.

You can visit industry-related Websites, such as www.lisassociation.org or www.lifesettlementawarenessmonth.com. A hand full of state-approved CE courses cover legislative issues and ways to seek reputable life settlement organizations. With the regulatory and industry information on these Websites and the tips provided here, you should be able to use life settlements to increase profits and expand planning options to senior clients. ❑

Larry Simon is director, is CEO and president of Life Settlement Solutions Inc. in San Diego. Life Settlement Solutions and its management have purchased life-insurance policies with nearly several billion dollars in aggregate face value to date. Life Settlement Solutions founded Life Settlement Awareness Month. This annual event offers top-of-the-line marketing support, training, and industry expertise to improve producer sales activities. For information, visit www.lss-corp.com or call 858/576-8067.