

Give Your Clients Accurate Information About Life Settlements

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Talk about mixed messages! A major life insurer warns its agents that life settlements present an “opportunity for fraud and abuse” – while conceding that “there are reputable organizations operating in the life settlement business.” *Advisor Today*, one of the leading voices of the financial services industry, carries an editorial ominously entitled “Agents Warned About Viaticals” – which simultaneously warns agents about getting involved in viatical and life settlements, while telling agents how to comply with state regulations so that they may legally advise their clients concerning viatical and life settlement opportunities. What is an agent to think? And what should an agent *do*?

One thing is clear. Demand for life settlements is significant and it is growing. Agents should not just steer clear of this lucrative market. Instead, agents should be guided by the same basic principles they apply every day: they should give their clients advice that is suitable to their particular situation, and they should comply with the rules and regulations that govern their sales activities.

Take the first of these principles, suitability of advice. The principles and codes of the Insurance Marketplace Standards Association (“IMSA”), require that insurers “provide competent and customer-focused sales and service.” To provide such service, agents must “analyze customer insurable needs and financial objectives to assist [customers] with making buying decisions about what is appropriate for them.” With the emergence of a mature and well-regulated life settlement market, a life settlement is suitable for certain clients and is many times the most suitable option. Agents must understand life settlements well enough to give their clients advice that is appropriate for their situation.

Consider Joe Businessman, a 62-year-old entrepreneur who was required some years ago to obtain \$3 million of term insurance on his own life to get a business loan. Now the loan has been repaid, and Joe no longer needs the insurance, but in the meantime Joe’s health has declined. He can either let the policy lapse, and get nothing for his years of premiums, or he can obtain a life settlement that provides a significant immediate payment. How can a responsible agent *not* learn about this option and *not* tell Joe about it and still provide advice that is suitable to his situation? The answer is clear: he can’t.

Like any other financial product, life settlements are subject to rules and regulations – which, like other rules and regulations, are frequently explained in local insurance industry forums, continuing education programs, and the like. These rules and regulations are no more or less complicated than those that govern other financial products agents regularly recommend to their clients.

The somewhat negative tone sometimes taken by the media toward life settlements stems less from the actual rules and regulations than from a series of myths that agents and advisors should understand:

Myth #1 Life settlements are never suitable to policyholders.

Critics commonly suggest that policyholders do not need life settlements and that the only party to benefit in the transaction is the life settlement company. The reality is that life settlements can be very beneficial to people in certain circumstances – and are in some cases the most suitable financial option available. For an individual like Joe Businessman, whose circumstances have changed since purchasing the policy, a life settlement may be the most suitable option. NAIFA agrees: “Life settlements occur because a policyholder’s circumstances have changed and the policy is no longer needed. In general, a life settlement can provide far more value than a simple surrender or lapse of the policy,” according to a letter from NAIFA’s associate general counsel dated June 30, 2000.

Myth #2 It is a conflict of interest for the agent who sold a policy to advise the client to sell it.

The fact that the agent earns a commission on the transaction has no more legal or ethical implication than it had when the policy was originally placed. NAIFA agrees again. It “does not see a conflict of interest for an agent who sold a life insurance policy to be involved in assisting that client in selling the same policy to a life settlement company,” if a life settlement is suitable for the client. Indeed, NAIFA understands that the original agent’s knowledge of insurance and the client’s needs puts the original agent “in the very best position” to help the client with a life settlement transaction.

Myth #3 Life settlements are coercive and unfair to selling policyholders because companies only offer settlements to financially desperate people who are near death.

Early viatical settlement firms limited their policy acquisitions to situations in which an insured had a life expectancy of less than two years and needed cash to pay mounting medical bills. In contrast, modern life settlement companies have developed actuarial models sophisticated enough to permit them to acquire policies on insureds with life expectancies up to 14 years – thus eliminating any perception that the insured may be making a settlement decision in a time of immediate distress. With a wider range of health patterns for which life settlements work, modern life settlement companies offer not a

desperate financial choice but a valuable financial tool useful to insureds facing retirement expenses, the sale of a business, a change in estate size, and other milestones.

Myth #4 A life insurance policy is considered a “security” for securities law purposes at the time it is purchased from an insured.

Some industry publications have warned agents that many states consider life settlements “securities” and suggested that, as a result, agents should determine whether they need to be registered under their state’s securities laws in order to have **any dealing** with life settlements. Agents obviously must ensure that they possess the licenses appropriate to any line of business in which they engage. However, from the agent’s standpoint, securities licensing requirements do not apply to life settlements because no state law or regulation has deemed a life insurance policy to be a “security” for securities law purposes at the time that it is purchased from a policyholder. States have applied their securities laws to “back-end” transactions, in which interests in policies are *sold* to investors, but such transactions do not involve the policyholder or the policyholder’s agent. Consequently, agents who merely advise their clients of the availability of life settlements and make introductions to particular life settlement firms generally will not be subject to securities-related licensing requirements, regardless of how the agent is paid.

Myth #5 Life settlements may violate the policyholder’s privacy rights.

Some people worry that investors will receive information about the health and habits of the insured. The industry, however, has evolved in ways that significantly lessen this concern. Early on, viatical settlement firms had limited access to capital and functioned largely by matching individual insureds to individual investors. Today, life settlement companies tap the full resources of the capital markets – major insurance companies, money center banks, and other investment banks. – to create pools of insurance policies as institutional investments. The policies in these pools are held by disinterested bank trustees. Because the private circumstances of individual policyholders are not material to the performance of such pools, there is no need to disclose confidential personal information about insureds to individual investors.

Summary

Life settlements are the right financial solution for certain clients, and agents have a duty to learn the facts about life settlements and inform their clients of those facts. Opportunities for continuing education about life settlements are readily available. Agents should avail themselves of these opportunities rather than relying on the mixed messages provided by the media, carriers and/or their broker/dealer.

In addition to helping their clients, agents will have the opportunity to participate in a multibillion dollar insurance sector that is expected to grow substantially over the next five years. That, clearly, is a win-win proposition.