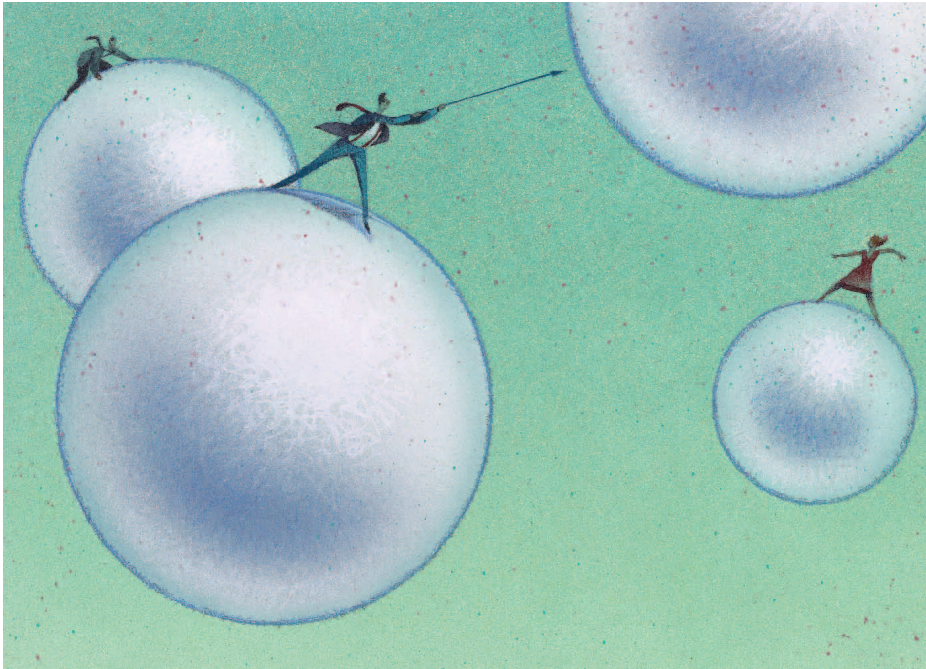


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Myth Busting in the Life Settlement Market



Having been involved in the life settlement industry for some time now, it amazes me how many experienced insurance and financial advisors are bewildered by this enigma called “the life settlement.”

To some, it is a mystery as great as the pyramids; to others, the concept is as offensive as ever imagined. I hope to dispel some of the myths surrounding life settlements, distinguish fact from fiction, and help advisors become comfortable proposing life settlements to clients — adding value to their practice. A life settlement is simply the sale of a life insurance policy for a cash settlement in excess of the current cash surrender value. The following describes what a life settlement is and what it is not.

Top 10 Myths

1. The client must be terminally ill

— This situation refers to viatical settlements. A viatical involves the sale of a policy insuring a terminally ill person, of any age, who generally has a life expectancy of two years or fewer. On the other hand, life settlements involve seniors who are typically 70 and older with life expectancies as long as 15 years.

2. It's a security — Life settlements are front-end transactions, which involve the sale of whole policies in accordance with all appropriate laws and regulations. They do not involve the back end. They do not involve raising capital or fractionalizing policies into shares for sale as an investment to individual investors. A security is an investment instrument, other than an insurance policy or fixed annuity, issued by a corporation, government, or other organization that offers evidence of debt or equity.

3. The client must be desperate for cash — The typical life settlement client is a 76-year old high-net-worth person who approaches the transaction as a business decision. The typical client owns an underperforming policy and is considering a 1035 exchange into a current generation policy. The client recognizes the value of being able to liquidate this asset for an amount greater than its cash-surrender value.

4. The industry is not regulated — Thirty-three states require licensure on the part of the facilitator of the transactions (the broker) and/or the activity purchasing the policy (the funder). In the remaining states, these transactions fall under the routine purview of the state's insurance commission. The industry's governing body — the Viatical and Life Settlement Association of America (VLSAA) — works closely with the National Association of Insurance Commissioners (NAIC). The NAIC has written a model act to encourage states to adopt uniform standards for regulating the life-settlement industry. California currently does not regulate life-settlement transactions.

5. Life insurance should never be sold — The reality is that if you have ever had a policy surrender or lapse you are already very active in the liquidation of life insurance policies. You are simply failing to benefit your clients. In a surrender scenario, the policy is sold back to the carrier for a predetermined price. In a lapse scenario, the policy is also sold back to the carrier, but at a zero price. A life settlement simply allows for the fair market value of the policy to be

recovered.

There was never a time when policies were purchased by some crooked character who ensured the policy matured in a timely manner. Today's life-settlement market is comprised of very sophisticated capital primarily from institutional sources. Policies purchased as a life settlement are a long-term investment for the respective funder. The policies must remain in force or the funder will never realize a return, so these policies will never lapse. Incidentally, trailer commissions and renewals continue. Even a term policy can be sold if it is convertible to permanent coverage or if the term of the contract exceeds the computed life expectancy. Term policies are a great way to generate new capital for your client since they have no accumulated cash value.

6. The whole process is cumbersome and inconvenient — The process itself is benign to the client. It entails only an application and some supporting documents. There is no physical examination. All underwriting utilizes existing medical records. The whole process normally takes six weeks to eight weeks to secure offers. It's hardly a burden considering that the appraisal process is free, non-binding, and could earn the client a significant financial gain.

7. Any senior with insurance will qualify — The most successful producers in this industry do not take a "spray and pray approach" hoping something sticks. They qualify potential candidates methodically to ensure that expectations are managed and that no one's time is wasted. Your clients hired a professional when they purchased their policy; they should expect the same professional service when it is time to exit the policy.

Other considerations when qualifying a potential case are the life expectancy of the insured, premium amounts, surrender amounts, and loan amounts. The life expectancy is determined through the underwriting of existing medical records. The market is embracing policies with life expectancies of between two years and 15 years. Premiums need to be level and ideally be between 2% and 4% of

the face. The cash-surrender value obviously has to be surpassed by any offer or it will not make financial sense for the client to pursue the settlement. Ideally, that amount should not exceed 30% of the policy's face value. Finally, there should be low to no loans against the policy because these loans will have to be paid out of any gross offer, thus lowering the potential return to the client.

8. The return is not worth the effort — Average returns in the industry can vary because the market is maturing constantly. It is not unusual to see returns as much as two to four times existing cash-surrender value or anywhere from 12% to 33% of the policy's face value. Since each case is unique, it is impossible for anyone to predict a return reliably without the requisite underwriting — hence the reason for the appraisal to be free and non-binding. If the return or offer is not appropriate, the client simply declines the offer. But, the client now has a true perspective of his or her overall net worth and can move forward in deciding what to do with the policy with confidence of having explored all of the options. The settlement is a windfall for the client and is a taxable event. In most instances, any settlement amount in excess of the cash-surrender value is taxed at the capital-gains rate. Please, always consult with your tax professional.

9. It's twisting or churning and it's illegal — Twisting and churning involve the use of misleading practices to induce a client to lapse, surrender, or terminate a financial product to effect a replacement for the purpose of generating a commission. These practices are usually illegal and always unethical. Neither applies to the life-settlement industry.

Potential life settlement candidates are typically identified through routine periodic insurance reviews or surrender or lapse notices, an automatic premium loan, or a past due premium notice. The professional advisor will only present the life-settlement option that is in the client's best financial interest. The life-settlement option is no more inappropriate than recommending a surrender, lapse, or

1035 exchange as an exit strategy for any life policy already in jeopardy.

It is true that the majority of life-settlement recipients reinvest the proceeds into a current generation product, such as an annuity, LTC plan, SPIA, MEC, or a new policy. This is not a replacement since the original policy is still in force. On every occasion in which the client reinvested their settlement, they benefited financially.

10. The liability is too great — It is impossible to reconcile any refusal to offer this service to your clients with your fiduciary duty to disclose material information to them. All reputable life-settlement providers offer E&O coverage for their advisors. Not to be aware of this liquidity option or to overlook disclosing to the existence of this tool to your client can only be considered contrary to the client's best interests. Any liability lies with the broker/dealer or carrier that prohibits its advisors from participating in the industry. In addition, disclosure and rescission provisions are built into these transactions to ensure that the client's rights are protected.

Every financial professional should be mindful of the spirit of the NASD suitability rule (Conduct Rule 2310) in his or her approach to life settlement transactions, even though the sale of a life insurance policy is not a securities transaction. The suitability rule provides that a member shall have reasonable grounds for believing that the recommended transaction is suitable for the customer based on the client's entire financial and personal profile.

I hope that this article will prove helpful as you conduct your due diligence on the life-settlement industry. A life settlement is a viable financial option for your senior clients. The market will continue to grow exponentially. As it becomes more mainstream, your clients will ultimately participate with or without you. □