

Learning Life Settlements 101

By Lawrence B. Patterson

The advanced market matrix is complex and interconnected. It is an amalgamate of life settlements, annuity rescue, premium financing and arbitrage opportunities through creative financial concept strategy implementations.

Don't wait to expose your clients to advanced concepts; you'll lose your client to a competitor. Worse, you could find yourself on the wrong end of a lawsuit because you neglected to execute your complete fiduciary responsibilities by letting a prospective client make life and financial decisions based on incomplete information.

If you ever found yourself a defendant in litigation brought by a former client, simply because you failed to inform them of the option to have had a previously owned life insurance policy appraised for potential secondary market value, your position will be indefensible.

Just like Enron lamely whined in court, "Well, Arthur Andersen told us to do this," I don't suggest you tell a judge that you failed to make a client aware of their potential settlement option — provided they met the qualification parameters — because your broker/dealer told you not to. Or even worse, that you failed to divulge this information and offer a free, non-binding appraisal option to a former client because you didn't want to "go there."

According to an article published by National Underwriter in September 2004, the majority of life insurance policyholders either let their policies lapse or surrender their policies for a minimal cash value.

According to the article's author, the wealth lost as a result of these policy surrenders is significant. The National Association of Insurance Commissioners in Kansas City, Mo., estimates that in 1996, for example, nearly \$1.5 trillion in life insurance face amount lapsed or was canceled by policyholders.

To understand how staggering this really is, let's look at some numbers based on recent life settlement cases:

\$44, 400,000 aggregate face value totals

Cash Settlement Value (CSV) = \$1,106,658

Life Settlement Value (LSV) = \$7,146,500

Using these numbers, the life settlements that were bid and accepted were 6.45 times the existing cash surrender value. If you back out the two included term policies, the adjusted aggregate face value total was \$34,000,000 with a total cash surrender value of \$1,106,658 and a total life settlement value funded of \$4,808,000. That is 4.34 times the aggregate CSV.

An industry study conducted in 2002 at the University of Pennsylvania's Wharton Business School found that life insurance policies typically sold in the secondary market for an average of 3.6 times the policy's (cash) surrender value. The average of the two equals 3.97. These numbers are close enough to demand that you stand up and pay attention to this market.

Therefore, it is axiomatic that a life settlement might offer three to four times the existing cash surrender value. In the case of term life, where there is no cash surrender value, the significance potential is five to six figures of liquid capital availability, whereas a lapse or surrender of the term policy would result in *zero dollars to the insured*.

Using the aforementioned life settlement cases, the median LSV to face, taking an average of the permanent life insurance policies combined with the average of the term life insurance policies equaled 15.115 percent% of face value. This is in line with current industry estimates that life settlement amounts average 15 percent of face value.

The cutting edge

I believe it is essential to be on the cutting edge of the total information stream to be knowledgeable, competitive and effective.

According to the results of an exclusive new study being published in the March 2006 edition of the Agent's Sales Journal, "To date, only 18 percent of the agent population responding to the survey have transacted a Life Settlement on behalf of a client... However, nearly seven in 10 have clients whose insurance needs have changed since purchasing a policy, and nearly half have clients who, in fact, have surrendered a policy... There are many reasons most agents have not yet taken the plunge, however. According to the study, the most common reason agents are reluctant to transact a Life Settlement is a lack of training and education. The number one challenge with presenting Life Settlements, as cited by survey respondents, is a lack of knowledge of how settlements work."

For those of you who fall into this category, I am extremely embarrassed. You would have had to have been sequestered in an underground bunker without access to the outside world not to have read the multitude of articles featuring life settlements in publications such as Senior Market Advisor, Life Insurance Selling, California Broker magazine, *National Underwriter*, *Advisor Today*, *The Economist*, *Bloomberg*, *The Wall Street Journal*, *Trust & Estates*, and countless other industry formats.

I am still constantly amazed, especially with the availability of the Internet, that I can talk to insurance and financial professionals on a daily basis who have never heard of life settlements or the secondary market.

Come on, guys, let's get with the program! Without belaboring the many potential applications of life settlements that always seem to be reiterated as a laundry list in most articles, let's cut to the chase.

It is incumbent upon you to offer a life insurance valuation for clients whom you can pre-qualify as potential life settlement cases for three main reasons:

1. There are statutory obligations that state legislatures have imposed on insurance providers and their licensed producers to uphold their fiduciary duties and disclose material information to consumers. If you wish to be IMSA compliant and provide customer-focused sales and service, you must disclose the availability of the life settlement option. Duty has no sweethearts!
2. If you are a securities registered representative, to be compliant with NASD Conduct Rule 2310, you must also disclose the availability of the life settlement option verses letting a customer surrender or let lapse a policy, or retain a policy rather than investigate and accept a life settlement, should they qualify. Setting any personal opinions aside, you must be indifferent as to a client's choice of proprietary or non-proprietary products or services. A life settlement is not a product; rather, it's a hybrid financial tool. A life settlement is the vehicle that liquefies the existing LSV bid and offered, once accepted by the client.
3. When applicable, a life settlement's LSV can be three to four times the policy's cash surrender value. The liquid capital availability differential between the LSV and the CSV can be a five-, six- or possibly seven-figure "off balance sheet asset" that can recast an individual's net worth and create significant additional monies to fund more cost-effective life insurance coverage, other financial instruments or investments that can maximize a prospective client's asset position. If the client chooses not to engage in reinsurance, their bottom-line financials are further enhanced by the addition of the recaptured premium outflow. When you understand and compute the time value of money, the ramifications of these application potentials become clear.

Next month, I'll explain how to identify potential life settlement clients, how to utilize the latest state-of-the art tools for pre-qualification, how to approach a prospective client, and marketing.

Relax. It's not that complicated. It's really a walk in the park