

Life Settlements: The Next Big Thing for Brokers

by Sid Friedman

One of the hot new products to emerge in life insurance over the last few years has been life settlements. Often misunderstood and wrongly termed "viaticals," life settlements provide brokers and agents a way to simultaneously deliver clients a cash settlement for an unwanted policy while spinning commission dollars out of seeming thin air.

The challenge to brokers who want to market life settlements is that their very sophistication disqualifies many agents from identifying, presenting and offering life settlement options to their clients. That's unfortunate, because the life settlement market has grown from \$200 million in 1998 to an estimated \$4 billion in 2003, according to Erich Sippel and Co, a life insurance consulting firm. And the market will grow to \$10 to \$15 billion by 2005.

Tapping that market, however, requires a psychological shift on the part of the industry and an ability to reframe life settlements away from traditional viaticals and toward the concept of a hidden asset that every level of the insurance and investor community needs to know about. Thanks to life settlements, there are billions of dollars that will soon be available on the marketplace currently hidden from our radar screens. Our job is to find these unwanted policies and communicate their value to investors, brokers, agents and consumers, advisors, accountants and attorneys—so they understand the legitimacy of the secondary life insurance market and the increasing role it will play in the life insurance industry of the future.

A new PR slant

As many of our clients have learned over the last three years, assets and personal wealth can disappear along with stock gains and losses. Indeed, since 2000, stock market losses total \$13 trillion, and equities have fallen 50% from their December 1999 high, creating the longest bear market since the Second World War, according to a February 2003 report by the London Business School. And the media has amplified the problem through an onslaught of coverage regarding the nation's collective losses. Ironically, consumers and even the media are now tiring of such negative stories and they are actively seeking positive investor news.

Life settlement could be such a story. In the last three months alone, the Wall Street Journal, USA Today, Forbes and The Christian Science Monitor have interviewed me on the topic. These are some of the most sophisticated media and personal finance reporters in the world.

Now, let me share a secret with you about them. None of them had ever heard about life settlements. In fact, the question out of their mouths is often, "Aren't these viaticals?"

The answer is, "absolutely not!" The difference is that viaticals simply accelerate death benefits for terminally ill patients – making them a product fraught with negative connotations and risks.

Life settlements, on the other hand, actually buy the policy outright from the owners and place it with institutional investors who have the financial wherewithal and sophistication to hedge and pool their risks and meet the premium obligations. Investors are rarely at risk. Once explained in these terms, the media is very receptive to the concept of life settlements and in fact have been covering the topic with increased frequency. This helps to educate the market as a whole.

Yet PR is not enough. Brokers need to do more to educate the market to the nuances of the product as well as work with those agents who do have the proper level of sophistication to market the programs and carry the life settlement banner into the marketplace. And what are those markets? They are more extensive than you could ever imagine, and they need to be sold vertically by market sector.

Where to find them

Finding a life settlement through simple cold calling or one-to-one marketing is analogous to trying to find a needle in a haystack. Rather, life settlements need to be marketed through others in the marketplace—vertical markets of their own that allow you to broaden your prospecting by educating influencers and gatekeepers. These include: Estate and trust attorneys. These are the individuals working at a high level of trust with affluent consumers who may benefit most from life settlements. They deal with the real issues of wealth generation accumulation and preservation, and have long-term client relationships. They understand the nuances of family businesses and personal estates—but surprisingly, even they don't even understand life settlements.

In fact, in a quick survey I conducted of 50 of my attorney friends and colleagues, only a few were familiar with life settlements and none had ever presented the option to client. Even more alarming, many reported that they had allowed life insurance policies to lapse—without valuing them—thinking instead it was best for an older client whose health or financial status had unexpectedly changed.

Here's a recent example from my files. John, the 76-year-old CEO of a family business was finally retiring, passing the reins to his son-in-law, Steve. Steve told me he needed to attend to some of the benefits John had had that he would no longer needed, among them a \$3 million "key man" term life insurance policy. He figured he would simply no longer pay the premium and let the policy lapse, thinking it was no longer of value.

I quickly pointed out to him that John's policy did have a value of almost \$1 million if sold as a life settlement. In essence, it was "found money." That sum would be more than enough to give John a little extra to enjoy his retirement, and allow Steve put some money back into the company he was now leading.

Mergers and acquisition attorneys. Sound far-fetched? Take this recent example from my files. A hotel holding company that was worth \$35 million decided to acquire a smaller operator with two owners that is valued at \$12 million. The health of both owners was failing and they never established an effective succession plan. The company owned two \$6 million universal life insurance policies—one on each shareholder. The owners' exit strategy was to use the insurance to purchase the other's outstanding shares, if one was to die. Though, that changed once an interested buyer appeared at their doorstep.

Both policies had a cash surrender value of approximately \$400,000. The sellers each wanted \$6 million in cash from the transaction. The buyer only had \$3 million. Where did the balance come from?

The buyer showed the seller that by selling the policies under a life settlement, the buyer and seller could realize \$2 million of immediate cash, not enough to close the gap entirely, but close enough. The remaining \$1 million difference could be financed over two to three years. The transaction worked out, but not without the infusion of cash from the life settlement.

Business consultants and attorneys. Any business consultants and attorneys who interface with public or private family-owned businesses may find reason to need cash. For example, I recently brokered a deal for the 84-year-old owner of a New York printing company. He had bought a \$3 million policy years ago to pay inheritance taxes on his estate. The falling stock market cut the estate's value in half. The owner wanted to save \$55,000 in premiums by letting half the policy expire but found investors willing to pay \$350,000 and take over the premiums.

Bankruptcy attorneys. When a company goes into bankruptcy for any number of reasons, the first initiative is to find assets and reduce expenses. A mid-size company with sales of \$50 to \$500 million dollars could have scores of life insurance policies in effect with everyone from directors to key employees in executive management. Typically, bankruptcy attorneys simply notify the insured individuals and ask if they want to assume their policies and pay sizable premiums on their own, and if not, allow the policies to lapse. But life settlement provides bankrupt companies an opportunity convert these policies into cash as part of a restructuring.

The opportunity in life settlements is large, and getting bigger. Indeed, as much as \$15 billion could be at play in just a few years. Life settlements provide a rare opportunity for the industry to create win-win-win situations, delivering sound returns for investors; unrealized commissions for agents; and cash to companies and individuals simply by selling unneeded life insurance policies.

However, achieving these wins requires an industry-wide effort to better position life settlements and market them in a way that does good for all interested parties.