



Estate Planning

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Life Settlements: The Emergence of a Nascent Industry

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According to a study released in June 2003 by Conning Research & Consulting, Inc., life insurers' profit margins—which Conning points out are already under intense pressure due to lower investment returns—are now being squeezed further by the rapid growth in the life settlement industry.

The meteoric rise in the industry has even caught the attention of overseas investors. As reported in the May 15, 2003 issue of the British business magazine *The Economist*, after savings accounts and government bonds, life insurance may be the most respectable of investments due to the new secondary market for life insurance policies. The magazine reports that life settlement firms bought \$2 billion worth of policies (by face value) last year—10 times as much as they acquired in 1998 when the industry first started to emerge.

Some estimate that the industry's potential is comprised of Americans over 65 years of age with life insurance coverage worth \$500 billion.

Investment opportunities aside, the fact remains that life settlements would not have gained in popularity had the industry not been providing a valuable service to policyholders. The secondary market was created by consumer demand, and as our aging population continues to soar and baby boomers begin reaching the life settlement threshold age of 65, the industry will likely experience steady growth for at least the next decade and longer.

A Pro-Consumer Wealth Management Tool

Just as Fannie Mae and Freddie Mac cre-

ated an active secondary market for home mortgages, life settlement firms are now playing a similar role for the sale of life policies that the owner no longer needs or wants. Prior to life settlements, policyholders had minimal "exit options" once they decided the policy was no longer needed. They either let the policy lapse or settled for its cash value—in either case leaving huge sums of money on the table of their life insurance company.

According to an article entitled "The Benefits of a Secondary Market for Life Insurance Policies" published in October 2002 by Professor Neil A. Doherty of the Wharton School at the University of Pennsylvania and Hal Singer of Criterion Economics LLC, "The creation of a secondary market or the enhancement of an existing secondary market improves the value of the underlying good to consumers by making it a more liquid asset." The writers conclude that a competitive secondary market for life insurance policies improves the welfare of both new and existing policyholders, and they call for lawmakers to design regulations that encourage, rather than dissuade, such participation or investment.

It's the Right Thing to Do for the Client

Producers will want to take heed of the "life settlement 800-pound gorilla." The word is getting around, and agents owe it to their clients to discuss the option where appropriate. Otherwise, they may find

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their clients wondering why their trusted adviser did not inform them of this option and may take their business elsewhere.

In fact, an article published in the *Pennsylvania Law Weekly* (January 5, 2004) entitled "An Often Overlooked Asset" states that an attorney has an obligation to analyze the circumstances to determine if a life settlement is possible to gain the most for the client.

When Should a Life Settlement be Considered?

Situations where a life settlement may be appropriate for a senior age 70 or older might include:

- divorce situations
- an underperforming policy that can be replaced with new coverage given the revised mortality tables, resulting in cheaper insurance for seniors
- when the senior intends to let the policy lapse because he or she can no longer afford the premiums
- business bankruptcy
- when the insured has outlived the beneficiaries
- when there is a need for liquidity to invest in new financial products, such as long-term care, annuities, stocks, etc.
- key person policies no longer necessary due to change in ownership of a business
- lifestyle changes where the policy is no longer needed in order for heirs to pay estate taxes upon the death of the policyholder
- buy-sell agreements where the policy that was previously purchased to finance a buy-sell agreement is no longer needed after one or more of the participants leave the business or it has been sold

Annuity Arbitrage and Life Settlements

Another popular use for life settlements is the "annuity arbitrage," where the proceeds

from the life settlement are used to purchase a single-premium immediate annuity (SPIA) and the monthly income from the SPIA is used to finance the premiums for a replacement policy. Such a transaction makes sense, especially when the policyholder has a rated health history. Life settlements and annuity arbitrage can present an extremely powerful option, and producers should be familiar with this transaction in order to advise their clients when such an option seems appropriate given the circumstances.

The Bottom Line

Life settlements grew out of a consumer demand by seniors seeking liquidity for life insurance policies they no longer needed or wanted. This new financial planning tool empowers seniors to make decisions regarding this aspect of their asset allocation. For financial service professionals to ignore this emerging market irrespective of its benefits to the consumer would be contrary to their fiduciary responsibility to the client.

It is important that financial professionals do their research on this emerging industry and weigh the benefits of this estate planning tool when presented with situations where it may be appropriate. ■

Noam S. Weiss is co-CEO of Settlement Benefits Association, a full-service life settlement brokerage in Tampa, Fla. Through a network of licensed funding groups, the company helps policyholders and their trusted agents to understand and maximize the value of life insurance products. Settlement Benefits Association accepts applications for policies of at least \$25,000 and has received the approval of the National Ethics Bureau, an organization of approved financial advisers who have maintained an exemplary record of business ethics. Mr. Weiss may be reached toll-free at 888-287-1437, or visit www.settlementbenefits.com.



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