National Underwriter P&C

A Primer For Agents Considering Life Settlements

BY SCOTT PAGE
President and CEO, The Lifeline Program

For agents considering life settlements for their clients, full disclosure must be embraced from the outset. It starts with analyzing the insurance policies being considered for a settlement and ends with a thorough review of the offer, closing statements and long-term plans for the policies.

Begin with a review of your state's life settlement regulations. Some states have no regulations while others are remarkably thorough. The agent and the provider must be compliant in the state in which the transaction is conducted.

Each life settlement must include an analysis of the insurance policy that is being considered and why that policy was purchased in the first place. Insurable interest is critical, as are other key issues.

While individual state definitions vary, insurable interest must be demonstrated in order for a life insurance policy to be valid. It must exist at the time of issue of the life insurance policy, or it is void as a matter of law.

It can be defined or determined in several ways including the following:

• The owner and beneficiary of a life insurance policy are closely related by blood or law.

• There exists a substantial interest between the insured, the owner and beneficiaries of the policy which is based in love and affection.

• The owner and beneficiaries have a lawful, substantial economic interest in the continued life, health and safety of the insured person.

Insurable interest is lacking when life insurance is underwritten in a scenario in which benefits arise or appreciate only from the death, disability or injury of the insured person.

If insurable interest is questionable, life settlement companies may not purchase the policy. Also at issue are so-called non-recourse premium financing arrangements.

With these arrangements, an agent or financial planner typically initiates the life insurance process, and the insured is often advised to create a vehicle such as an irrevocable life insurance trust (ILIT), a limited partnership or a limited liability company to own the policy. Instead of the policy owner paying the policy premiums, a lender provides funds to the policy-owning entity to pay premiums for the first several years. As a result, the lender obtains a collateral assignment on the policy. These arrangements can be problematic for a number of reasons, and insurance carriers may begin to call them into question.

Other issues which need to be considered are instances of "wet paper" and "cleansheeting." If an investment company induces a policyholder to buy a policy, and then the policyholder turns around and sells it soon thereafter, this is considered wet paper and can be rejected by life settlement providers.

If a medical report for the policy was manipulated so that the policy would be more attractive to the secondary market, this is considered cleansheeting, and such practices are illegal and therefore closely

scrutinized by life settlement companies and regulators.

Once it is determined that a policy can be sold into the secondary market, agent responsibility shifts to ensuring that the transaction is in the client's best interest by following these steps:

--Work with a provider with extensive experience and knowledge of industry regulations.

--Request the provider place funds in escrow during change of ownership.

--Consider probate or estate issues arising from the transactions.

--Determine the provider's approach to administering the policy moving forward from the transaction date.

--Review the provider's approach to tracking activities such as how the insured will be monitored and notification procedures upon the insured's demise.

The final and most important piece to the compliance puzzle is transaction transparency. This term has been buzzing around life settlements for the past several years, and its time has come. Those who advocate for transparency want every policyholder who sells a policy to know exactly how much is being paid out and who is receiving a commission. Though most in our industry believe that every life settlement transaction is unique, the manner in which the commissions are determined should move toward standardization, and the exact details of the compensation structure should be disclosed to the policyholder.

The life settlement industry is quickly moving toward adopting precise disclosure forms for all life settlement transactions. Such a form is presented to the policyholder at the conclusion of a closed transaction, and it discloses the amount of the life settlement along with the fees paid to the life agent, broker and provider company. Agents performing life settlements should insist that this form be provided to their clients.

Full disclosure, compliance and transparency are critical for the short- and long-term health of the life settlement industry. At present, such activities protect the policyholders, agents and investors. For the future, potential growth sources for the industry hinge on complete transparency. For the most part, the industry has embraced these disclosures and settlement companies have incorporated them into their policies and procedures. However, all agents should and must know and understand these issues if they are to properly represent themselves and their clients.

Scott Page is president and CEO of The Lifeline Program, Atlanta, Ga.