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Life Settlements Are A Key Element In Financial Planning For Seniors

Several years ago, brokers helped clients choose an estate plan, life insurance policy and planned giving schedule that would best fit their needs, based on their projected end-of-life desires. Now those middle-aged clients have reached retirement age.

As one might expect, people's lives and needs change drastically between ages 65 and 85, and previously made financial plans no longer apply. Thus, some may have life insurance policies they no longer want or need, giving you a new reason to get in touch with long term clients.

Seniors View Life Settlements As Beneficial

According to the National Association of Securities Dealers, life settlements have become an important component of financial planning for some seniors. By liquidating a policy for an amount higher than the cash-surrender value, policy owners receive cash proceeds prior to policy maturity, higher cash payout than the cash-surrender value, profit from under-performing assets, and relief of monthly premium expenses.

As a result, life settlements have become increasingly popular with seniors, who often use the cash proceeds as a means of funding annuities or other investments, supplemental retirement income, or new options in estate planning or planned giving, which may better suit their financial goals.

Education Is the Key

Once eligible policyholders recognize their life insurance policies no longer fit

current or future needs, savvy agents and brokers can provide a valuable service by helping clients convert their life policies into cash. Part of the process for agents and brokers will include answering a myriad of client questions. In order to provide answers and obtain the best settlement for their clients, it is imperative that life settlement brokers and agents understand both the life settlement market and the companies with which their clients will enter agreements.

The Market and Its Participants

In a nutshell, the life settlement process works like this: A life insurance policyholder sells the benefits of the policy to an investor. Most investors do not directly negotiate with policyholders; rather, they provide financing for life settlement companies that facilitate the buying of the policies.

Policies considered for purchase by life settlement companies must meet certain eligibility requirements. Typical criteria formed with the life settlement companies, investors or lenders are as follows:

- Any policy must be beyond any carrier or statutory contestability period, and fully renewable subject only to the payment of premiums.
- The insured's life expectancy is between 25 and 144 months, based on one or more medical evaluations from an approved evaluator.
- Term policies must have a minimum term life insurance coverage equal to the greater of two times the life expectancy, or 10 years.

- Minimum policy face value is \$250,000 and the insured must be 65 or older.

As the new policyholder, the investor must maintain all premium payments in order to keep the policy in force. The concept is much like buying and selling mortgage contracts—in this instance an insurance contract is bought and sold.

The primary source of financing in the life settlement industry is institutional investors, including banks, insurance companies and hedge funds. Some of Wall Street's biggest money players are vying for a piece of what is estimated to be the \$15-billion-a-year face value business of life settlements. Hedge fund managers, in particular, are viewing life settlements as a stable investment and are including it in their portfolios. Consequently, there has been an increase in activity in this asset class by some of the world's largest hedge funds.

Once a hedge fund manager decides to pursue the life settlement market, he typically works with the life settlement company to identify policies that will produce the desired business results, in addition to developing a portfolio of policies that meet the expectations of the fund's investors.

Hedge fund managers invest in life settlements by purchasing a group of life insurance policies to create hedge funds. While returns are difficult to determine

from one policy, a group of policies creates returns based on the law of large numbers. Although these returns are not exact, they can be forecasted based on information provided by the insured, including actuarial data and medical information. Investors find this attractive, as life settlements are not tied to the stock market and are based on data that is independent of market fluctuations. Another attractive feature: Life settlements have the potential to produce attractive yields.

Identifying the Right Life Company

Agents and brokers should perform due diligence by gathering information from several competitive companies, targeting those whose senior management has had the most life settlement experience. A German company known as Scope Group has become active in rating and ranking life settlement companies, so far the only company to do so. Scope offers information on its website at www.scope-group.com. Agents and brokers should seek companies with an "A" rating or higher.

In addition, the following guidelines can help agents make the right choice for themselves and their clients:

- Solicit bids only from providers that are both experienced and ethical. Regulation of life settlements is not the same in all states, and some states do not regulate the industry at all.

- Select a life settlement company that is licensed or otherwise qualified to do business in the state in which the policyholder resides.

- Look for proven industry experience, preferably at least \$500 million in purchased aggregate face value to date.

- Confirm that the company is institutionally funded and will not resell the contract to an individual investor.

- Check with the state attorney general's office or state insurance department for any complaints or legal action against the settlement provider.

- Insist on a settlement provider that uses reputable, independent financial institutions to hold the money in escrow until the change of ownership closes.

- Determine and disclose all tax implications to your client.

A Rapidly Growing Industry

The future looks good for the life settlement industry, which has grown leaps and bounds in recent years. Life Settlement Institute released statistics in April 2005, indicating life settlements gave life insurance policy owners more than \$1 billion over cash surrender for their policies.

As the life settlement industry profits, so do brokers and agents who have realized the additional revenue stream life settlements bring to their organizations. 🌐