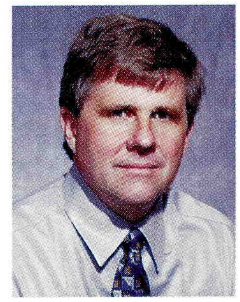
How Life Settlements Became an Integral Part of the Financial Services Industry



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By Steve Shorrock, ChFC, CLTC, FLMI

In 1911, Dr. A. H. Grigsby treated a patient named John C. Burchard, who was to undergo surgery. Mr. Burchard offered to sell Dr. Grigsby his life insurance policy in return for $100 and for agreeing to pay the remaining premiums. His doctor agreed... and so the first life settlement transaction was born. When Mr. Burchard passed away about a year later, Dr. Grigsby tried to collect the benefits. An executor of Buchard's estate, R. L. Russell, challenged him in Appeals Court and won. The case eventually reached the United States Supreme Court where Justice Oliver Wendell Holmes Jr. delivered the opinion of the court. The crux of his opinion may be found in this brief excerpt:

*So far as reasonable safety permits, it is desirable to give to life policies the ordinary characteristics of property. To deny the right to sell except to persons having such an interest is to diminish appreciably the value of the contract in the owner's hands. **

Justice Holmes' decision set forth the fundamental principle upon which the life settlement industry is now based: **a legitimately-issued life insurance policy is private property, which can be assigned at the will of the owner.**

Seven decades later, during the 1980s, viatical settlements emerged as a direct result of the AIDS epidemic. This third party purchase of an in-force life insurance policy was a mechanism for financing health care or final expenses for terminally ill patients. Viatical settlements were attractive to investors with the promise of high returns, partly because of the very short life expectancies of insureds.

The introduction of protease inhibitors in the mid-1990s helped AIDS patients live much longer. Good for the patients, bad for the investors who had purchased their policies.

Yet viaticals genuinely helped many early AIDS and other terminally ill patients, spurred life insurance carriers to offer accelerated benefit options and validated the concept of a secondary market for life insurance policies.

After a near-death experience, the industry had an epiphany in the late 1990s: insureds need not be terminally ill and returns don't have to be above 20%. Senior settlements, commonly known as life settlements today, first appeared 10 years ago, in 1998. They are available to those aged 70+, or those 60+ with severe medical issues.

The Supreme Court could have never envisioned that a century after their landmark ruling, life settlements would emerge as an integral part of the financial services industry. There is now regulation in most states, with New York coming soon. Life expectancy determination models as well as pricing models have been developed and standard contracts are being issued. There are various trade associations. My partner, Russel Dorsett, serves on the Board of Directors of the Life Insurance Settlement Association (LISA).

Bernstein Research (*Life Insurance-Life Settlements,* 2006 Update) says the life settlement market is in the midst of high growth and will continue its upward trend as the baby boomer generation enters retirement. Industry experts predict that by year 2030, there will be 72 million seniors age 65+ who will control $800 billion of life insurance, of which $161 billion would be eligible for life settlements.

I receive phone calls on a daily basis about the viability of selling a life insurance policy in the secondary market. The value provided to consumers is often multiples of the Cash Surrender Value they would receive if they "settle" (surrender or lapse) with the insurance company. It is the agent's fiduciary responsibility to present a life settlement as an option for elderly clients.

A strong secondary market makes life insurance a more attractive product as having a potential "exit strategy" will ultimately encourage more people to purchase life insurance. What's more, it opens the door to new products that focus on living benefits as well as death benefits. FA

*Doug Head, *Association Profile: Life Insurance Settlement Association. Agent's Sales Journal,* March 2006.

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