



Adviser Soapbox

Playing Death Futures

Peter Katt 07.19.07, 3:00 PM ET

The market for the buying and selling of life insurance policies for investment purposes had a rational basis in the beginning. Increasingly, though, this market is evolving into transactions where the main purpose is to charge exorbitant fees and commissions. Life insurers are also going after the wealthy elderly, convincing them to *rent* their high net worths and their lives to become insured for the sole purpose of then selling the life insurance policies.

Obviously, it wasn't always like this. The original life settlement business plan was to buy unwanted or unneeded policies from insureds over 65 whose health had deteriorated more than just the passage of time. This provided mortality arbitrage needed to make the purchase price higher than a policy's surrender value. The major player has been Coventry First, which has a strong financial relationship with American International Group. It is my understanding that Coventry buys policies for institutional investors and that there is no chance an individual investor can learn who the insureds are. Coventry has stated it has a traveling covenant that protects insureds from becoming known to individual investors. This protects insureds of policies that have been purchased by Coventry.

Another settlement firm with major institutional financial support is Maple Life Financial, although it may not feature the traveling covenant to protect insureds as Coventry claims to do. Because Coventry and Maple both claim major institutional support, their offers should be in line with the life settlement market's current expected yields. Their offers are probably most accurate and likely lower than may be made by settlement brokers packaging policies and selling them to smaller financial institutions and individual investors.

It is likely that some 95% of potential policy sellers should retain them. There are only two situations where selling a policy is the best choice. One is an insured that wants cash. The other situation is a policy with heavy surrender charges and poor pricing. A \$5 million policy we are dealing with right now has poor pricing with combined premiums paid of \$225,000 but only \$25,000 of surrender value. It is in the client's best interest to replace it with a legitimately better-priced policy. We believe a legitimate life settlement offer will be around \$125,000, and this will make up for some of the surrender charge loss, with the client ending up with a much better policy.

Almost all other possible life settlement situations should result in the policy owner retaining the policy, at least until the policy will terminate. Let's say a policy owner named Don wanted to stop paying premiums on his \$1 million universal life policy with \$100,000 cash values. Now, at age 72 and with health problems he didn't have when the policy was purchased at 60, Don can sell the policy for \$275,000. But he doesn't need the cash—he just wants to stop paying premiums. So the best move is to keep the policy for another five years using the \$100,000 cash value to pay the cost of insurance. After five years, the policy would be worth around \$475,000 in the life settlement market (Don's life expectancy is getting shorter). There is about a 35% probability Don will die during those five years. Keeping the policy during that time allows his beneficiaries to receive \$1 million tax-free if he dies, and Don will very likely improve his situation if he waits and sells in five years.

But here is the alarming news. Unfortunately, the life settlement business has evolved into transactions where the main purpose is to procure obscenely high fees and commissions. The life settlement industry

and their solicitors have created the image that many policy owners often come to the rational conclusion they want to sell their life insurance policies and then contact an agent. *This is a false picture.*

Almost always, it is the agent soliciting policy owners to sell their policies because of the very high commissions they are paid. In the situation described above, the agent recommending the sale for \$275,000 would be paid around \$55,000--meaning the life settlement firm would have paid out \$330,000 for the policy, but Don would not have known about the \$55,000 going to the agent. Katt & Co. handles life settlement negotiations for our normal hourly fees. A case like Don's would usually incur fees of around \$5,000, saving him \$50,000.

The appetite for doing life settlement transactions has become so great (due to the grossly high fees and commissions) that the industry no longer is satisfied having only conventionally purchased life insurance policies as possible purchase targets. Instead, big shooters solicit wealthy seniors to rent their high net worths and lives to become insured for the sole purpose of then selling the life insurance policies. These transactions involve a third party paying the premiums and paying the wealthy senior a bonus for renting his life. As my May 2006 AAll Journal column shows, there is little rational math involved in these representations, and I am convinced that the end investor will lose a lot of money.

I believe the main trick being used is to represent a shorter life expectancy than is in fact the case. This substantially increases the expected yield and will attract individual and small institutional investors--including, I believe, newer hedge funds. Regulators and ethical life insurance companies are doing battle with the developers of this horrid practice of investor-initiated life insurance.

My advice: Do not buy life insurance policies unless you retain astute professionals that are completely independent to review each situation. If you don't, you are likely to lose your shirt!

I have had three experiences of individual investors being sent complete information about the insured, insurance company and policy they have invested in or bought. In each situation, the settlement company that sold this investment denies it ever give out the names of insureds. They have lied to me. If sellers of life insurance policies knew their policy could end up in Tony Soprano's IRA, they would be more cautious about whom they sell to.

The most egregious situation I have seen is an agent that caused \$30 million of life insurance to be placed without the client's knowledge by paying the premiums himself and owning the policies. ([Click here for more on this](#)). This came to light when he tried to get the insured to agree to turn over medical records so the agent could begin selling policies. Now there are cross litigations going on.

Another awful situation came to my attention while writing this piece. A Midwestern stock broker called me explaining that he sold clients \$3 million of life insurance several years ago insuring their mothers in order to sell the policies to a settlement firm. The attempt wasn't successful because they didn't think the offers were high enough, and he asked my assistance in helping them find premium financing because the premiums weren't affordable. If you can't sell the policies, there is little opportunity to find premium financing. Turning family members' deaths into profits is a terrible thing.

An estate planning attorney called me to inform me he had invested \$50,000 in a life settlement policy (one of the situations that disclosed the insured's name) based on the representation that the settlement company had a 15-year track record of providing investors with average 16% yields. Nonsense. Life settlements haven't been around 15 years, and the yields are nowhere near 16%. This attorney was planning on recommending this to his clients.

I hope regulators have the wisdom and courage to put the life settlement genie back in its bottle and return us to where it began. There is a nice secondary market for the very few situations in which it makes sense to sell a life insurance policy.

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