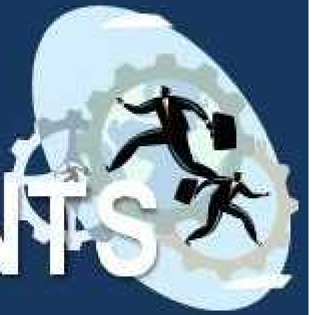
Robin & Peter on LIFE SETTLEMENTS



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What You Should Know About Settling Problem Policies

Certain factors can drastically impair the value of policies on the life settlement market. Due to the economic downturn and anti-STOLI legislation, we have seen an uptick in the number of "problem" policies being submitted for settlement.

- **Policies issued by lower-rated companies.** These policies add two additional risks that most investors don't want to take on. First, there is the possibility that the company may not be able to pay its claims even though state guarantee funds may offset some of this risk. Second, poorly performing companies present a greater risk in that they might have to increase the current cost of insurance charges or lower the crediting rate. In fact, such actions may even be required by regulators.

- **Premium financed policies.** There is currently a tremendous amount of litigation across the country surrounding these policies. It is alleged that a number of these programs financed policies in a manner intended to circumvent insurable interest laws; that they were Stranger Originated Life Insurance (STOLI). Furthermore, insureds may have been encouraged to misrepresent financial and other underwriting information when applying for the policy. In any event, investors view these policies as carrying a significant risk of rescission by insurers. Additionally, investors typically don't want to be put in the position of trying to determine if a financing program was abusive or not, so some just say no to all financed policies.

- **"Wet ink" policies.** The settlement of policies that are still contestable is prohibited or severely restricted in many states. Even where permitted by law, contestable policies carry additional risks. First, the insurer is not barred from contesting the policy for misstatements. Second, disposing of a policy so quickly after acquisition raises suspicions that it may have been a STOLI transaction.

Despite these problems, there are a few investors willing to buy these policies. They view the additional risks as an opportunity to obtain much higher returns than industry norms. It takes, however, a very special and unusual combination of short life expectancy and low policy cost to achieve the abnormally high returns that these higher risk investors expect. Unlike the normal life settlement market, these investors must look at hundreds of policies to find one that meets their exceptional targets, and so the chance of getting an offer on such a policy is extremely low.

One way to make such low odds work financially for brokers and funders is to require that you, the agent, provide and/or pay for medical records and life expectancies. Some brokers may use the carrot of new funding sources for impaired policy placements as a come on, but they are far more interested in a "bait and switch."

To meet the needs of our brokers and your clients, we also have funders that will consider these problem policies. It is important, however, that you and your clients understand that such transactions contain special risks for you and for them. First, you may unwittingly become involved in an unlawful STOLI-type arrangement, as it is not just the inception of such transactions that are prohibited in many states. Participating in the settlement of one of these policies, even unknowingly and far removed from inception, could put you at risk. Second, the funder may not perfectly fit the profile of solid institutional investor, that most insureds are comfortable with owning a policy on their life.

Some of these policies have a legitimate need to be settled, but the buying parameters are very limited. Our experience gives us the insight to know when a policy has any reasonable chance to attract offers from quality investors and we can help you sort out the fact, fiction, and risk of problem policy settlements.

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