Senior Market Advisor

If life settlements are good enough for Warren Buffett shouldn’t they be good enough for everyone else?

Mary Hillenbrand
March 2002

Last October, Gen Re, the global reinsurance and risk management arm of Buffett's Berkshire Hathaway Inc., arranged a financing facility upwards of $400 million for Living Benefits Financial Services LLC, a life settlements funder in Minnetonka, Minn. Similarly, sources close to Life Equity LLC, of Hudson, Ohio, say that company has also secured a comparable amount from Buffett's group and since many life settlement executives say attracting and keeping institutional money is the key to detaching the life settlement market from its viatical roots, Buffett's involvement adds an air of credibility to a business overrun by scams by shady brokers and small investors often unprepared to handle the risk.

"We don't want bad actors in the industry," explains Doug Head, executive director of the Viatical and Life Settlement Association of America, "and we've certainly taken enough thumping in the press." But can the industry do enough to prove to Buffett and other high-profile investors its willingness to reform?

A new way of doing business; 2002 is starting off on a better foot, some of the bigger life settlement companies say, thanks to new funding arrangements with Gen Re. The reinsurer has brought consistent financial backing and a name that will inspire more confidence in the life settlement business, argues Steve Ballard, CEO of the Norseman Group, a marketing and brokerage company based in Minneapolis. "Berkshire Hathaway/Gen Re adds huge prominence and credibility to this business. It has generated a ton of business and has opened doors that previously weren't open to us."

Institutional investors can have a significant impact on the life settlement business' image by not allowing a single life insurance policy to take on the importance it does for an independent investor, notes Brian Smith, CEO of Life Equity. When an institution buys a policy, it is often placed with other policies into a portfolio where they are maintained to maturity or sold to another institutional investor in aggregate. An individual or group of individuals that band together to buy one policy, on the other hand, have far more riding on the seller's life expectancy. "The flow of institutional funds makes it a stronger business," agrees Michael Krasnerman, CEO of AllSettled Group Inc., a New York life settlement broker.

Building a new reputation; Gen Re did not enter the business lightly. Known as a careful investor who does painstaking research, Buffett is said to have personally required that the life settlement companies Gen Re backs follow the guidelines in the National Association of Insurance Commissioners' model state law for licensing life settlement agents. Paul Moe, chairman and CEO of Living Benefits explains that institutional investors are accustomed to stringent guidelines for any transaction because they have to protect their own reputations among their own shareholders. "When you're funded by institutions, you don't have a choice. You either act like a consumer finance company or you don't have any financing," Moe notes. "We decided early on we were going to maintain those institutional disciplines." Institutional investors are banking on this new emphasis on operating cleanly and professionally, Ballard says. Partnerships like the Life Settlement Institute and the Producers Alliance, as well as the VLSAA and the NAIC, support uniform regulation of the business, careful attention to detail and a greater emphasis on ethics than many in the viatical business have demonstrated.

The NAIC and the VLSAA have been working for years toward uniform state licensing rules that would control, but not stunt, the growth of the viatical business. Recently, they have added the life settlement business to their efforts. "Markets respond to economic realities rather than what we might wish the situation to be in a regulated environment," Head says. "Our real objective is to create a functioning market."

For example, the VLSAA is trying to get regulators in Texas and Florida to accept a standardized life settlement contract that all agents doing business there could use. The contract, which Head hopes will catch on in other states as well, reduces paperwork for agents, saving them time and money.

Some in the life settlement business, however, argue that the VLSAA is not in position to promote guidelines that will attract institutional investors, because that group represents both viatical and life settlement players. Noting the viatical business centers on smaller contracts and smaller investors, six life settlement-based companies say their new Life Settlement Institute will promote the institutional side of the business without risking conflicts within its membership. The Life Settlement Institute was launched in late January as a non-profit group consisting of Life Equity, Living Benefits, Coventry First LLC, of Fort Washington, Pa., Life Capital BV, of San Diego, Peachtree Life Settlements, of Boca Raton, Fla., and Stone Street Financial Inc., of Bethesda, Md. Members must have a minimum audited commitment of $50 million in backing from institutional investors.

The LSI plans to educate institutional investors and work with state licensing commissions to develop strict but market-friendly rules for agents and brokers. LSI also will engage in federal lobbying to make life settlements more attractive to large policy owners. The Producers' Alliance, a small group of life settlements brokers, is also focused on education and attracting bigger money to the business. Greg Albers, president of Life Insurance Buyers Inc., in Kansas City, Kan., Michael Quinn and Ron Biglin, founders of Estate Trust Inc., in Baltimore, and Paul Nagelberg, president of ELA Viatical Services, in Newark, N.J., founded the alliance in 1994. The alliance, which is actively seeking new members, pledges to work only with funders backed by institutional funds, and members agree to shop each policy to all institutionally backed funders, to increase competition. The group also vows to only work with brokers and advisors who are licensed where they do business, and to support the NAIC's efforts to promote uniform regulations in all states, Albers says.

Fine-tuning the regulations; Hoping to show institutional investors they are not afraid to do business by the book, all of these life settlement proponents support state laws requiring life settlement agents to get licenses. "Clearly, regulation unto itself is not going to cause an industry to grow, but it can be a source of reassurance for some people," Smith says. The current focus, however, is on helping states develop licensing rules that do not burden agents and funding companies, which slow growth. Getting licensed is "a huge pain" in most states, Albers says. "In some cases, it's near impossible. They're being very hard on the producers." In California, the annual license fee is a steep $3,000, Albers says. In Kentucky, licensees are required to get 40 hours of continuing education credit per year to stay licensed, he adds. "There isn't 40 hours of literature out there for us to learn!" Others, however, worry about making the laws powerful and enforceable. Though the states are trying to police unlicensed sales, Gloria Wolk, a California-based financial consultant and author of several books on viaticals and life settlements, estimates as many as 50 companies regularly market life settlements without a license in states where it is required. Meanwhile, the penalties for operating without a license or for committing fraud in viatical and life settlements are too light to discourage people who are lured by huge commissions. "Penalties don't work as a deterrent," Wolk argues. "They're an encouragement, because people can see clearly their potential risk." Albers agrees. "Tell a guy scamming people out of millions of dollars about a couple thousand dollars fine, he's going to laugh in your face."

Buyer's protection; States cannot be the sole solution to the fraud problem, most in the business agree. Funders must try to protect themselves by performing due diligence before making an offer on a policy. Life Equity, for example, carefully scrutinizes insurance policies and the holder's medical records for discrepancies in the information used to calculate life expectancy, Smith says. Living Benefits does the same, according to Moe. Both companies, as well as the other institutionally funded firms, typically get help from producers to do that research.

AllSettled looks primarily for corporate-owned or trust-owned insurance policies to shop to buyers, Krasnerman says. "We deal with high caliber individuals and corporate policy owners. These people rely on advisors to help them understand the deal. These are people who will be educated about financial issues," he explains. Nevertheless, some investors are still getting scammed. "There are sleazy [brokers] that are also getting big, institutional money, because the institutional funders don't know how to do due diligence," says Wolk, who charges $400 an hour to help companies do that research. For big-money deals, Wolk typically charges a $25,000 retainer to delve into the policyholder's history. She checks medical background, lifestyle factors and life expectancy reports issued by anyone who has been involved in the policyholder's healthcare.

Monitoring the foot soldiers; Life settlement companies are eager to spread the word about the opportunities in this new market, but most agree advertising directly to consumers is not the answer. Even if it means spending time and money to educate and monitor financial advisors and insurance agents, Albers argues, life settlement firms need to recognize that those are the people who have the policy holder's ear. Consumers, especially seniors who do not feel confident about their own financial savvy, want to hear about life settlements from a "trusted intermediary," he says.

Until recently, life settlement companies have not made a strong enough effort to bring financial advisors and agents into the fold, Smith argues. "Generally there is not a good understanding [among advisors] that they may have more clients than they might expect for whom life settlements are appropriate," he says.

Albers argues that educating clients on this option could be viewed as a financial advisor's legal obligation. "What you're doing is providing your customer with the service you promise," he tells advisors. "If they don't tell [their clients] that this is an option, they risk the chance of a lawsuit." Life settlement companies typically require financial advisors to follow strict guidelines, to cut down on mistakes that can tarnish a company's and the industry's image. The bulk of Living Benefits' oversight work hinges not on weeding out scam artists, Moe notes, but on teaching and enforcing high standards. "There's more sloppiness than there is unscrupulous behavior," he says.

The industry must also deal with old issues such as suitability and anti-churning. However, several companies such as Living Benefits and Life Equity provide an extra check on the agents, examining a seller's financial situation to ensure he or she is qualified to sell the policy, while others have instituted strict anti-churning safeguards. Reputation aside, Albers still sees the industry putting the cart before the horse. There are plenty of players in the industry looking to promote their brand, but that means nothing if the brand has no association. "How can you convince anyone to buy Wheaties," says Albers, "when they don't even know what breakfast cereal is?"

Source: Senior Market Avisor Magazine, March, 2002, reprinted from the World Wide Web at:
http://www.producersweb.com/home/index.php?rIDX=299&pageID=contentFocus&adcID=983868e060b4a8a9466bea1d5c082404,