

# Agents Walking A Tightrope On Life Settlements

BY MATT BRADY

**A**GENTS WHO ARE counseling their clients about life insurance are not required by law or regulation to present the option of selling their policy in a life settlement, but many believe it is in their best professional interests to do so.

"I don't know if obligation is the right term," said Robert Nelson, vice president and life and estate planning manager for the Grace/Mayer insurance agency in Omaha, Nebraska, of an agent's duty regarding life settlements.

However, he noted that he had "built a practice, and many others have too," by ensuring that clients have all of the possible options before them. "I don't know how I could not let them know about a viable option and still hold myself out as a professional," he said. "I wouldn't go mandating anything, but I think it's the difference between one set of advisors and another."

Some agents, however, are barred from raising the issue of life settlements with their clients by their carriers, to the point where doing so could even be grounds for termination.

Nelson argued that agents who find themselves in that situation could provide a reference to an agent free to discuss the life settlement option, just as an agent who does not sell Medicare supplementary coverage might recommend an agent who can help a client procure that coverage.

"This is not rocket science," he said. "It might be a young business, but it's a fairly established business."

Former Illinois Insurance Commissioner Nat Shapo, now serving as chief compliance officer for the Coventry Group in Philadelphia, also noted the difficult position of agents who are prohibited by their carriers from discussing life settlements, and the effects of that position on those carriers.

"Agents are trained and licensed to

give full information about their clients' insurance contracts terms and benefits," he said. "Anything that prevents them from doing so puts them in an untenable position."

That surrender values are generally significantly lower than the final benefit of selling a policy, he added, "creates a bad picture" when insurers are the ones trying to keep agents from counseling about life settlements.

But one argument against life settlements, according to John Skar, chief actuary and senior vice president at MassMutual, is that they are very rarely an appropriate measure for a client.

Skar said he's examined many of the marketing materials offered by life settlement companies and concluded, "I don't think it measures up to what agents and consumers need to know."

Only a very few policies are actually eligible for life settlements, Skar noted, estimating the number at less than 1% of MassMutual's in-force policies. "It's not something that applies to many people," he said.

Perhaps the greatest drawback for life settlements, he said, is the amount of transaction fees that would be incurred as part of a transaction.

"To sell a policy, you incur very high transaction fees, many times higher than virtually any other financial product," he said, adding that in many instances these fees "are not disclosed."

If a client were considering a life settlement, Skar said his advice would boil down to the simple question of whether the client has any sort of estate need, meaning, would they like to leave an estate to an heir or charitable organization? If the answer is yes, he said, then it would make sense to keep the life insurance policy and sell off other assets that would carry far lower transaction fees.

According to Skar's estimate, "Around 50% of the estate value is destroyed in these transactions" involving selling a life policy. "This is the big message that's not getting out to the consumers."

For the "very, very small subset" of those with high value policies and no estate needs, Skar said life settlements would be an appropriate option. "We

don't think that's going to happen very often," he said, estimating that perhaps 1 in 10,000 policyholders would fit that description. "We don't think there are too many people with a million dollar policy and no estate needs."

Douglas Head, executive director of the Life Insurance Settlements Association, said agents should be concerned about the consequences for themselves if they fail to bring up life settlements with a client who later finds that a life settlement would have led to more money.

#### THE AGENT'S DILEMMA



■ **Robert Nelson**, a past president of the National Association of Insurance and Financial Advisors, says there could be errors and omissions ramifications for agents who do not offer life settlements to their clients as an option.



■ **Nat Shapo**, former Illinois insurance commissioner who is now chief compliance officer for the Coventry Group says, "Agents are trained and licensed to give full information about their clients' insurance contracts terms and benefits. Anything that prevents them from doing so puts them in an untenable position."



■ **John Skar**, chief actuary and senior vice president at MassMutual, says, "We're not banning anything, but we advise agents that if they are compensated for a life settlement transaction, they are not covered by Mass Mutual's errors and omissions coverage for that."

When agents ask him what can be done, since they're barred from offering life settlements, Head responds with a question of his own. "I ask them, 'what will happen if you are sued by a client, for failure to disclose this as an option?'"

Usually, he said, they respond by saying their errors and omissions coverage would cover any award, but Head said he believes that E&O insurers won't let the issue go forever. "Sooner or later, the

companies that are providing the errors and omissions coverage are going to have to decide" if they should continue giving this coverage to insureds or adjust their rates.

Nelson does not view the issue as one of fearing a client might take action afterwards, instead seeing it from a more professional angle.

"Rather than saying should they or shouldn't they take action, I'd turn it around," and simply ask whether the agent had done their job. As an example, he noted that several years ago a client he'd sold a life policy to earlier called him in the early days of the life settlement business to ask about a policy for which he could no longer afford to pay the premiums. At the time, Nelson said he didn't have any considerable knowledge of life settlements, and he told the client that although he should examine the life settlement option closely, it was a viable option. As a result, he said, "a \$900,000 life policy with zero cash value was sold for \$375,000."

If, instead, he or another agent counseled against considering a life settlement, Nelson said, "I'd have to ask, what kind of damage have I just done to this person?"

Shapo echoed that sentiment, arguing that a professional would want to make sure they have done the most possible for their clients.

"If you've got a client that is talking about letting a policy lapse and you're counseling them," then an agent should look at whether that policy is viable for a settlement, he said. If the agent fails to mention that, "that's not a position you want to be in, as an insurance professional."

Not mentioning life settlements, Shapo said, would be failing to provide the full information to a client on all the possibilities facing them.

"These days, that's clearly a viable option," he said of life settlements.

While he preferred to look at the issue from a professional perspective, Nelson did acknowledge that there could be errors and omissions ramifications for agents who do not offer life settlements to their clients as an option.

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## TIGHTROPE

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There have not been any such instances yet, but Nelson noted that "usually there's a lag with E&O claims."

And even if the clients or the agents themselves have not yet considered the E&O consequences, Nelson said the companies writing the E&O coverage have begun looking at the issue.

Nelson is a past president of the National Association of Insurance and Financial Advisors, and he currently manages an errors and omissions program for NAIFA members. In discussions with claims specialists for the program's carrier, Nelson said, "The claims specialists have said they feel that this would be a significant omission."

As a result, Nelson said that, were he employed by a life carrier that forbade discussing life settlements, "I would go back and ask them," about how to operate with the potential E&O risk.

### E&O CONCERNS

"It's a question that every professional deserves to ask," he said, adding that in such situations, "it's my net worth," that could be affected if a court award exceeds E&O coverage.

So far, though, he added, there has not been any pressure on the issue from E&O carriers, although he said, "It ought to be on the radar as they go about their renewal discussions."

MassMutual's Skar said the company does not prohibit its agents from doing life settlements, although the company views the activity as "sort of an outside business" from their duties with the company.

"We're not banning anything," he said, "but we advise them that if they are compensated for a life settlement transaction, they are not covered by Mass Mutual's errors and omissions coverage for that."

Head believes the litigation issue will surface in the courts at some point, and provided an example of a case.

In this instance, he said that a friend, who was not a client, told him that he had surrendered a \$500,000 policy for \$11,000. The friend is an 80-year-old man, Head said, and could have made "considerably more" through a life settlement.

"That man's agent was not looking out for him," Head said. "I think that's irrefutable."

Eventually, he said, the issue will play itself out. "Sooner or later, there's going to be litigation on this," he said, adding that the effects would likely be the key to changing E&O companies' stance on the issue.

Shapo noted that in addition to the courts, other venues for insurance regulation have also begun to examine the issue, and that current trends would seem to favor agents who raise the issue of life settlements with their clients.

"All of the trends in regulation and in the law push for enabling a consumer to make an informed decision based on all their options," he said, adding that any impediment to that train of thought would be "running upstream" with current regulatory and legal thought.

Shapo said a legislative fix to the problem is in the early stages, with bills "prohibiting the muscling of agents and requiring notification" being introduced in several jurisdictions. He added that the proposed laws would be fair and create a level playing field for life settlements.

Shapo acknowledged that insurance carriers' skepticism of the life settlement market could be understandable given the past issues with viaticals, but said the life settlement market of today is very different.

"In the past, there were a lot more concerns about the nature of the market, which might have formed the basis for their conclusions," he said. Today, however, life settlements are "at the point where the market is recognized, viable and provides a clear benefit to consumers."

He added that he also fails to see "any concerns for carriers that could outweigh a consumer's right to know" about all of their options. "The issue is, should they be fully informed of their options in terms of a life settlement versus lapse or surrender?"

Until a solution to the issue is worked out, either by policymakers or through the courts, agents will remain in the middle, but Head believes that the desire to best serve their clients and fulfill their professional, if not legal, obligations will win out.

"At the end of the day, agents clearly want to do this, and clearly understand that this is a legitimate option for their clients," he said. "They're frustrated with the pressure that they are getting from other actors on the stage and the anxiety that they may be failing in their fiduciary duties." ■

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