

FOCUS RETIREMENT SECURITY: LIFE SETTLEMENTS

Settling Premium-Financed Policies Can Be Thorny For Agents, Clients

BY MATT BRADY

AS THE LIFE SETTLEMENT INDUSTRY continues to grow, agents are increasingly likely to come into contact with one of the subsets of life settlement transactions: those involving premium-financed insurance policies.

Premium financing was around long before life settlements came into being in the insurance industry. At the recent Life Insurance Settlement Association conference in New York, Scott Cipinko, executive director of the Life Insurance Finance Association, said premium financing is among the more misunderstood issues within the life insurance and life settlement industries. These mechanisms, he said, were designed for "someone who has their capital tied up but is considered 'wealthy'" and needs to protect their assets.

Robert Finfer, president of Integrity Capital Partners in Bethesda, Md., said he expects to see considerable growth in the life settlement market for premium-financed policies over the next 36 months as those policies with non-recourse financing reach the end of their financing period. Typically, he said, non-recourse financing programs are designed to run for 24, 30 or 36 months, and the uptick in premium-financed policies that began a few years ago means that more and more of those policies will be brought to the secondary market going forward.

Brokers within the life settlement industry offer 2 main pieces of advice to agents who have clients with premium-financed policies and are looking to bring them to the secondary market. First, agents need to ensure that they have all of the documentation relating to the premium-financing agreement, and second, they should

absolutely seek out advice from others who have more expertise on the issues connected to premium finance and life settlements.

"The first thing that I can think of is that they need to understand what the premium finance documents say," said Ted Pryor, CEO of Stamford, Connecticut-based LifeOptions LLC. "Each program is a little different" in the details about the timing of repaying the loan and the process, he added.

Premium-financing programs, he said, generally give the insured a "window" of time to refinance the policy or pay back the loan, with the deadline for this usually occurring about the time of the end of the contestability period. It is imperative, Pryor said, to know exactly how repaying the loan would work beforehand. Otherwise, it can cause major problems in trying to conduct a settlement transaction.

An agent should also read through the documents to learn exactly how the transaction or repaying the loan should work out, which can sometimes be difficult in and of itself, he added.

"It should be spelled out in the documents, but it might take a few read-throughs to understand exactly how it will work," he said.

Because a life settlement transaction by itself can take 3 to 4 months, Pryor said agents should give themselves at least that amount of time before the financing "deadline" to consider a possible life settlement.

"Because you're up against a deadline," he explained, "you don't have the luxury of

going back to get something you forgot."

Those agents who don't, he cautioned, will find themselves with very little room to maneuver.

"We've had folks come in 2 weeks before the deadline," he said. "It makes it really difficult and limits your options. You basically can only go to the program and ask for an extension, and they don't have to give it to you."

One potential pitfall that agents should avoid, he said, is simply going back to the entity that financed the initial policy. While those entities offering the premium financing may be more than willing to purchase the policy, they may not be offering the best price. "You're better off getting that out

to a broker that knows the ins and outs of the different funders," Finfer said.

The importance of seeking out a broker was emphasized by both Finfer and Pryor, and although noting that it would certainly be helpful to them, they both also pointed out that the complexities of bringing a premium-financed policy to the secondary market make a level of expertise all the more necessary.

Premium-financed policies are not facing the same market as more traditional life settlements, Pryor explained. "Not all life settlement buyers are buying premium-financed policies," he said. "Many don't buy them as a matter of policy," he added, citing the reason for most as "conservatism."

That conservatism extends to some brokers as well. Eric Rosenthal, founder and president of TRG Capital Group in

SOME TIPS

2 PIECES OF ADVICE

- 1 AGENTS NEED TO ENSURE** that they have all of the documentation relating to the premium-financing agreement.
- 2 AGENTS SHOULD SEEK OUT** advice from others with more expertise on the issues connected to premium finance and life settlements.

Farmington Hills, Mich., takes a simpler approach to premium financed policies by simply staying away from them.

"I don't do it," he said, adding that while he doesn't believe premium-financed policies, or those who would broker a life settlement involving them, are a problem, he personally feels that the issue of insurable interest is one that carries with it a significant vulnerability to litigation.

While that same fear might serve as the source of some funders' concern regarding premium finance policies, Finfer noted that sometimes it is simply a matter of money. Because a funder purchasing a premium-financed policy might be expected to cover the loan as part of the transfer, which would require establishing a mechanism for handling the debt, some smaller funders have been concerned that it affects their ability to compete overall. "They might be able to make an offer, but it might not be as sweet as it could be" without having to maintain a mechanism for premium financed transactions.

Both Pryor and Finfer said that a good broker would be able to help identify not only which funders might be open to purchasing a premium-financed policy, but also which funder might have more experience with certain financing mechanisms and entities that are connected to the policy.

An agent, Pryor said, "is going to want some help finding the best buyer."

The repayment of the loan, Pryor said, creates a difficult, "chicken-or-the-egg" situation in which the policy can't be transferred and the collateral assignment can't be released until the loan is repaid, but the proceeds that might repay that loan from the sale of the policy can't be paid until the policy is transferred.

"It's trickier than you would hope to use the life settlement proceeds to pay off the debt," he said.

Pryor compared the situation to the sale of a mortgaged home, in which the title is held by a lender and needs to be released for the sale to go through. The difference with a life settlement involving a premium financed policy, however, is that while a sale of a mortgaged property will involve all of the players, it is "difficult to get the life insurance company to the table, if not impossible."

Finfer also noted that a broker will be able to identify those buyers with mechanisms in place to bridge the gap between the repayment of the premium-financing loan and the life settlement payment. The issue of repaying the loan is the crux of a life settlement involving premium-financed policies, and he noted that most policyholders who obtain a financed policy aren't going to have the means to repay

what could amount to 2 years worth of premiums, plus interest.

In rare instances, Pryor noted, some policyholders have had the means to cover the debt personally, but others have taken out bridge loans. One possible area of assistance, he noted, could come from the financing entity itself.

"I wouldn't hesitate to call the program manager and talk with them," he said, noting it can help "get a sense of what they intended" for the repayment process and clarify any lingering questions.

Even beyond the repayment of the loan, Pryor advised that consulting a tax advisor may be a good way to "make sure that you aren't picking up any additional taxes" in the course of the transaction.

If a significant amount of the proceeds is going to repay the debt of the premium financing, he said, it is important to make sure "you're not walking into a situation where you are paying taxes on the full amount and then using the proceeds to pay off the debt and interest."

Overall, Finfer said that transactions involving premium-financed policies can be "dramatically different" from other life settlements, adding an additional level of complexity to an already complex process.

"It's not a simple transaction," he said. "Even a simple life settlement transaction is not a simple transaction." ■