

## Close-Up on Life Settlements

# The Life Settlement Broker: An Integral Player in the Life Settlement Supply Chain

by Sean McNealy and Marlene Frith

The explosive growth of the life-settlement marketplace continues to baffle many experts in the financial services sector, some of whom are waiting on the sidelines trying to decide which direction the industry is headed before jumping into the fray.

Remarkably, the life-settlement marketplace has doubled over the past five years. Few industries can make that claim. While many industries were forced to downsize following the burst of the tech-bubble and the aftermath of the 9-11 tragedy, the life-settlement industry was ramping up and moving forward at a rapid clip. According to Doug Head of the Viatical and Life Settlement Association of America, membership in the industry's trade organization has at least doubled over the past five years.

The life-settlement industry is comprised of a complex combination of life-settlement brokers, insurance agents, financial advisors, policyholders, CPAs, attorneys, funders (providers), medical underwriters, institutional investors, investment bankers, escrow agents, and securitization experts. With approximately five to six years under its belt, the life-settlement industry is still in the introductory stage of the product life cycle. The life-settlement industry seems to move ahead as if by the force of its own energy, despite the fact that the early stage of any product requires educational outreach and substantial advertising investment. Some industry experts estimate that life-settlement deal volume ranged from \$6 billion and \$8 billion in 2004.

If one had to identify a force driving the industry to its rapid expansion, it

would likely be the life-settlement broker. "Larger, experienced brokers who have been operating since the product's inception provide a valuable service to everyone along the supply chain — from the policyholder to the provider," said Craig Seitel of Abacus Settlements, a life-settlement provider. "A reputable life-settlement broker brings more to the table than simply functioning as an intermediary between policyholders and funders."

### Marketplace Milestones

The products' metamorphosis from viatical settlements to senior settlements has helped shape the industry and define its growth. The industry entered a new phase of growth with the shift from terminally ill AIDS patients to high-net-worth seniors generally over the age of 70, said Boris Ziser, securitization expert and partner with the international law firm of Brown Rudnick Berlack Israels LLP. "This shift, or product enhancement, ushered life settlements into an era of sophistication and a stage of the product life cycle that brought greater credibility with a clearly defined value proposition for all players in the supply chain."

Some industry insiders believe that the securitization of life settlements played a critical role in bolstering the product's credibility because it brought substantial sums of investment capital to the table from domestic and international sources. Along with that capital, comes the need for securitization experts, investment bankers, and attorneys with tax and international law experience.

As with any product or service, consumer demand is driving the growth in the life-settlement marketplace. Accord-

ing to Larry Simon of Life Settlement Solutions, "There are approximately \$12.7 trillion of life policies in the U.S. With approximately 10% of the insureds at least 70 years old, the market has an estimated value of \$50 billion to \$100 billion." To underscore the value to the consumer, Simon noted that the National Association of Insurance Commissioners in 1996 estimated that nearly \$1.5 trillion in life insurance face amount lapsed or was canceled by policyholders.

### Life Settlement-Backed Securities

In April 2004, *The Wall Street Journal* reported a major milestone in the industry with a groundbreaking bond sale. It involved a large domestic investment banking institution that handled the private placement for \$70 million in bonds backed by life insurance policies, which were rated by Moody's Investors Services. Also in 2004, A.M. Best assigned a debt rating to one securities transaction in which asset-backed bonds were collateralized with \$195 million in face value of life insurance policies purchased from people with life expectancies ranging from 48 months to 84 months.

Some industry insiders expect the investment banking pace to accelerate in the near future due to the increased demand from the domestic and international investment banking communities looking to purchase portfolios of policies. Investments in life settlements are attractive because, if structured correctly, they can provide substantial returns beyond those received from the more traditional investment vehicles.

Another factor that is likely to increase the involvement of investment bankers and further involvement of rating agencies is the longevity and the maturing of the industry life cycle — and thus the opportunity to securitize “seasoned” portfolios. For example, A.M. Best recently published its methodology for rating life settlement-backed securities. Generally, the company will rate a transaction that is collateralized by an existing life-settlement portfolio under certain conditions — one is that all the life settlements in the portfolio must have been purchased at least five years before the date of A.M. Best’s evaluation of the transaction. Thus, the timing of A.M. Best’s first rating action mentioned earlier in the amount of \$195 million coincides with the period that the life-settlement industry began emerging in the late 1990s.

A.M. Best also notes that policy count and policy size are factors in rating considerations. The company expects the collateral pool to consist of at least 200 policies and it states that no life insurance policy should comprise more than 3.33% of the face value of the entire collateral pool. Therefore, including jumbo policies of \$10 million to \$50 million in face value is considered only on a case-by-case basis as it pertains to rating activity for securitization.

### **The Life-Settlement Broker — A Value-Added Intermediary**

With the expansion investment in and securitization of life settlements, institutional and investor-funded providers will continue to refine the criteria for the policies they purchase. Part of the process involves identifying and establishing relationships with life-settlement brokers who can supply policies that match their parameters and portfolio objectives.

Providers often turn to the life-settlement broker with an established reputation. Working with seasoned, established brokers who employ extensive compliance and underwriting staffs, helps minimize legal or regulatory concerns later on. In addition, larger brokerage firms have the marketing capacity and relationships with agents and financial professionals to promote the product within the financial and insurance industries in

order to sustain a steady supply of product.

Borrowing a term used in the technology industry known as “value-added reseller,” a life-settlement broker’s role might be characterized as a “value-added intermediary.” In the computer industry, a value-added reseller takes an existing product, adds its own “value,” and resells it as a new product or package. In addition to reselling the product, value-added resellers may also offer strategic planning, training, technical support, and other services.

The life-settlement broker is a funding intermediary between agents/clients seeking to sell a policy and a provider looking to purchase it. However, the following is a more sophisticated description of a life-settlement broker: The broker offers a turn-key, value-added service to agents and financial professionals who are seeking to sell their clients’ policies on the secondary market, but do not have the resources or expertise to provide case underwriting; perform due diligence on potential providers/funders; or effectively broker the policies to multiple funding institutions in pursuit of the highest offer.

The broker is also a value-added supplier of policies to providers, funders, and investors that have undergone an intensive underwriting and screening process, which involves the following:

- Policy analysis,
- Life expectancy evaluations
- The gathering of all pertinent documentation, such as medical and policy release authorization forms, attending physician statements, physician letters of competency, verification of coverage, trust documents, and so on.

### **Leverage is the Bottom Line**

Agents who want the highest possible offer for their clients’ policies will want to work with an established life-settlement broker rather than risk being presented with a lower than market offer without recognizing it. Life-settlement brokers can leverage a number of variables during the negotiating process and bring unique assets to the table including the following:

- Industry experience brokering many offers on the secondary market.
- Institutional knowledge and profes-

sional working relationships with multiple funders.

- Resources and critical mass to conduct due diligence on new funders entering the marketplace.
- Familiarity with each funder’s pricing models and unique parameters such as type of policy, life expectancy, size of policy, amount of premiums, states in which the funder is licensed to transact business, and similar compliance issues.
- Speed to market, negotiating skills, and volume pricing opportunities.
- An understanding of each individual funder’s investment sources, portfolio profiles, and securitization factors.

In addition, an established life-settlement broker with longevity in the industry is likely to provide other services to the agent and financial professional beyond simply brokering the policy to multiple funders in pursuit of the policy’s fair market value on the secondary market. Services may include E&O coverage, marketing and strategic planning, seminars to educate financial professionals about the life-settlement marketplace, sales training, marketing/graphic design support, and compliance assistance. Such “ancillary” services for a seasoned life-settlement broker who is operating at the national level would generally require a staff of approximately 25 to 50 people.

Although marketplace barriers to entry are minimal and new life-settlement brokerage companies are emerging within this rapidly expanding industry, only a few life-settlement brokerage companies have been operating since the industry’s inception and provide the turnkey and ancillary services described in this article. As the industry matures, the “established life-settlement broker” will become even more critical as a value-added intermediary and an integral link in the life-settlement supply chain. □

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