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Death benefits ruling may make life tough for advisers

Experts say insurers will work to discourage life settlements sales

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By Darla Mercado
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A recent ruling by New York's top court regarding life settlements may be good news for hedge funds, but it could slam advisers and brokers who facilitate these transactions.

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On Nov. 17, the New York State Court of Appeals ruled that state law allows people to buy a life insurance policy with the intent of immediately selling it to an investor who stands to make money when the insured person dies.

The closely watched case centered on Alice Kramer, a widow who sued for $56 million in coverage on behalf of the estate of her late husband. Before his death in 2008, Arthur Kramer, an attorney, bought seven insurance policies and placed them in trusts in the names of his three children. At his request, the interests were sold to hedge fund investors in exchange for cash.

The court's decision breaks the life settlement issue into two parts. It found that New York's insurance laws bar people from wagering on others by directly buying insurance on them and making the beneficiary someone who doesn't have insurable interest. However, the court ruled that state law does permit insurance contracts to be "immediately transferred" to another entity if the insured person is acting on his or her own initiative.

The language in the law — and the transactions by Mr. Kramer — predate New York's law banning stranger-originated life insurance sales, which seeks to protect vulnerable people from unscrupulous insurance dealers. That law went into effect in May.

Following this decision, New Yorkers with policies still will have to wait two years following issuance in order to sell their policies, but now the insured person's intent to sell is no longer an issue, said Julius Rousseau, a partner at Arent Fox LLP.

He expects states with insurable-interest laws similar to those in New York — including Delaware, Florida and New Jersey — to reach similar decisions in life settlements cases.

The ruling is a boon for hedge funds, who have bought billions of dollars in life settlement policies in recent years — and will likely influence the outcomes of similar cases in other states.

The decision, however, may prompt insurers to ramp up underwriting on policies and find other ways to curb licensed agents from participating in the controversial practice, experts said.

"From the perspective of an agent or financial adviser, the analysis doesn't end at the decision; they still need to comply with the parameters of their agency agreement, and that could preclude this decision," said Luigi Spadafora, a partner at Winget Spadafora & Schwartzberg LLP.

"You'll likely see carriers who don't want to be in this market require insured individuals to certify either in the application or upon policy delivery that they have no intention of transferring that policy," he said.

Through their selling agreements with their sales forces, insurers also can still bar agents from discussing life settlements with clients. Prudential Financial Inc., for example, prohibits its captive force from discussing life settlements with clients, but third-party independents aren't bound by the same rules.

"Insurers have always had the right to work with whom they want and to discipline their agents," said Doug Head, executive director of the Life Insurance Settlements Association. "If insurers want to say, 'We don't think you did the right thing and we don't want you to represent us anymore,' that's always in the scope of possibility."

Others expect insurers to toughen underwriting procedures prior to issuing a policy, which could slow business down. "I suspect that underwriting is just going to get even worse, and from the administrative standpoint, questions on applications are just going to be tougher," said Lori Skibo, director of national sales at Rita Robbins Associates Inc., a life insurance wholesaling and brokerage firm. "It's also possible that they may reduce compensation schedules."

Ms. Skibo said she expects legitimate life settlements to take more time to process if insurers crack down on underwriting.

Moody's Investors Service Inc. last week called the court decision a "credit negative" event for life carriers.

"An increase in policies that are sold to investors in the secondary market will reduce insurers' profitability as the value in such policies is extracted and maximized by third-party investors," Scott Robinson, a senior vice president at Moody's, wrote in a report, noting that other states may follow New York's lead.

E-mail Darla Mercado at dmercado@investmentnews.com.

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