Viatical Response

In his reply to our article on life and viatical settlements in the March/April issue of *Contingencies*, Joseph Belth claims that "the important question is whether a [secondary] market for life insurance policies. . . should be legitimized and encouraged." His answer, of course, is "no." But he poses the wrong question—which leads him inevitably to the wrong answer.

However reluctantly, Belth acknowledges that the secondary market for life policies "has existed for centuries and will continue to exist." The reason for this, of course, is that both sellers and buyers find it in their interest to participate in the secondary market. In a free economy, that is the only reason any market exists. Thus, Belth's insistence that the market be discouraged and considered illegitimate is nothing more than elitist presumption: Since he disapproves of the market, buyers and sellers ought not to participate in it. If only they knew what Mr. Belth knows and thought as he thinks!

Since the secondary market will continue to exist, the right question to ask is not whether the market should be legitimized and encouraged, but how to foster its ethical operation, maximize its transparency and efficiency, and minimize or eliminate potential problems. In our article, we answered that question. The market should be regulated to ensure the anonymity of the insured and to require full disclosure to both buyers and sellers. Anti-fraud statutes should be vigorously enforced. Participation in the market of institutional investors, who are increasingly replacing individuals as buyers of life insurance policies, is a welcome development that should be encouraged. One reason for the growing prominence of institutional investors is that states are regulating settlement transactions today—notwithstanding Belth's assertion that settlements are somehow beyond regulation. This has contributed to giving institutional investors—like the one that recently committed $250 million to purchasing life settlements—confidence to enter the market. Belth's apparent unawareness of the activities of institutional buyers probably accounts for his inaccurate assertion that the secondary market is shrinking.

Our recommendations would ensure a secondary market free of the problems that cause Belth such concern: unethical market conduct, and incentives for murder arising from lack of insurable interest. Full disclosure, prosecution of fraud, and replacement of individual by institutional investors leave no room for criminals to defraud the uninformed or naïve. Guaranteeing the insured's anonymity protects the privacy of his or her medical records.

Belth confuses ends with means when he insists that without insurable interest an incentive for murder exists. Requiring an insurable interest is one—but only one—method of eliminating incentives for murder. Belth's strange discussion of life-only immediate annuities unwittingly highlights the point. Underwriters of such annuities benefit financially if annuitants die early and suffer financially if they die late—obviously creating an incentive for them to shorten the lives of annuitants. Remarkably, Belth suggests that this is not a concern because the "cessation of relatively small periodic payments" is insufficient to motivate murder. Evidently, Belth is not opposed on principle to incentives for murder, but only to ones he considers overly lucrative.

Actually, of course, annuitants are protected—but not because the amount of money involved makes murder more trouble than it's worth, and not because of insurable interest either. Life insurance company executives will not hire hit men to murder annuitants for any amount of money; their own ethics, plus strong legal and social sanctions—not a non-existent insurable interest—are what protect the annuitant. Similarly, insurable interest is unnecessary to protect sellers of life insurance policies. Assuring the insured's anonymity accomplishes the same end. In fact, the seller of a life insurance policy whose identity is unknown to the buyer is better protected than the owner of a life-only immediate annuity. The annuity writer knows whose early death would benefit it; the settlement investor does not.

Belth finds it "ironic that the viatical or life settlement broker may be compensated far more handsomely for an easy selling job—persuading the insured to accept cash for a policy—than the life insurance agent was compensated for a tough selling job—persuading the insured to buy the policy." If Belth's unexpressed assumption—that hard work should be compensated more highly than easy work—were adhered to in the marketplace, ditch-digging would pay more than life insurance selling.

In a free economy, compensation is not paid for effort, but for creation of value. Whether selling a life insurance policy or a life or viatical settlement, the salesperson is attempting to add value for the customer. The salesperson's compensation derives from that value added. Since settlements routinely provide policyholders several times the policy's cash value, the value created for the customer in a settlement transaction (i.e., the excess of the sale price over the cash value) is often much greater than the value created by the initial sale of the policy (i.e., the cash value plus the value of mortality protection and the salesperson's advice). Ironic or not, there is nothing economically irrational or ethically questionable about paying commissions on settlement transactions—even if they exceed compensation paid on the original sale.

At bottom, the case for the secondary market in life insurance policies is pro-freedom and pro-consumer. The existence of the secondary market eliminates the disadvantageous situation in which

policyholders have traditionally found themselves in disposing of an unneeded life policy: being able to sell to only one buyer (the company that issued the policy) at a price set by the buyer. That restriction on freedom doesn't apply to the sale of any other asset. From stocks to bonds to houses to automobiles, sellers are never required to sell only to one predetermined buyer. Nor do they ever relinquish their right to try to obtain the best price. Why should life insurance companies alone enjoy this protection from competition?

Belth is certainly correct about one thing: Incentives are important. But the monopsony Belth defends creates incentives for insurance companies to take advantage of their policyholders.

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Added Coverage

Neither of the March/April 2002 *Contingencies* articles on the viatical market sufficiently covered several major points.

Major insurance companies have added accelerated benefits to their in-force and newly issued policies in recent years. An accelerated benefits feature pays a significant portion of the policy's face amount if the insured is diagnosed with a qualifying terminal illness. The remaining face amount is paid on the insured's death. As the accelerated benefits feature increasingly becomes standard on all in-force life insurance policies, activity in the terminal illness sector of the viatical market will continue to decline. Most insureds will take the accelerated portion and have the beneficiary collect the remaining death benefit, rather than viaticate for a portion of the face amount.

An insured with an extremely short life span may die before the policy's sale to an investor, thus benefiting the "house account." A two- or three-month time lag exists between the date a company buys the policy and the date it may be sold to an investor. Viatical companies normally sort policies into life expectancy categories and also may decide in a non-random manner whether to keep an individual policy or sell it to an investor. While very short life expectancies of six months or less can be estimated with reasonable accuracy, accuracy drops off for every successive six-month period.

One legal change would reduce fraud. Insurable interest is legally required on the day of policy issue, but not a day later when the policy is sold to someone without insurable interest. Currently, the insurer processes any written change in ownership or beneficiary request without review. Requiring proof of insurable interest to effect a change in ownership or beneficiary during the policy's contestable period would allow insurers to process legitimate requests for changes in ownership or beneficiary and disallow requests related to "clean-sheeting" and other fraudulent schemes.

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Murder for Profit

Dr. Belth's major objection to life settlements seems to be that they constitute an "inducement to murder" through profit to investors who benefit from the "early death" of an insured. He uses the murder ploy at least three times, but he cites no cases in the 20th or 21st centuries.

Well, if he's searching for valid critique, his hysterical arguments are misdirected; actually, there have been hundreds—perhaps thousands—of murders of insureds committed by policy beneficiaries, even in current times. By his logic, then, it is the sale of life insurance policies (!) that should be prohibited because such policies may be—and in too many cases, have

proven to be—an inducement to murder.

Ridiculous? Of course. The murder factor, as he uses it, is an irrelevant diversion. And his other objections to life settlements are just as empty.

The real murder, in a practical sense, is the financial murder of those who are denied the benefits of life settlements when the recovered money would buy lifesaving medical provisions or procedures, or vast quality-of-life improvements. Some Americans are literally dying due to lack of money. If Dr. Belth wants to discuss murder for profit, perhaps he should direct his investigative talents to writing about those life carriers which, for obvious self-serving profit motives, strictly prohibit their agents, under threat of termination for cause, from being involved with life settlements. By doing so, of course, they are in effect barring many innocent victims who depend on their agents to offer professional advice from being informed about potentially lifesaving steps. Financial murder for profit through coercion of agents? This bears investigation.

I think it's important to volunteer my financial interest. I am a life insurance seller, consultant, and distributor who also offers life settlements. I do so for a profit. And I am an insurance journalist who reveals his possible conflicts of interest when taking a position on debatable topics. Readers should know.

Dr. Belth, an academician and businessman, is editor of an excellent insurance periodical from a presumably unbiased base. Does he—cited in his article as a professor emeritus and as an author but showing no connection to any insurance firm—have an unrevealed financial interest in opposing life settlements? If so, who is paying him? Without implying anything, I think your readers are entitled to his response to these questions.

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Joseph Belth responds:

Mr. Goodwin and all of us can agree there are many murders attributable to life insurance, even where an insurable interest exists. However, that is not a reason to ignore the potential problems when a transaction creates an incentive for murder. There are many cases of arson attributable to fire insurance, but no one uses that fact to argue for abolition of the insurable interest rules in fire insurance.

Mr. Goodwin's reference to people "dying due to lack of money" may apply occasionally to the terminally ill. I say "occasionally" because of the increasing use of accelerated death benefits and other arrangements for the terminally ill. However, his reference generally does not apply to life settlements, especially where settlement firms consider only policies of $1 million or more. Owners of those policies are unlikely to be needy.

It is true that life insurers may have some incentives to oppose life settlements, but there may be disincentives as well. In any event, I agree with most of their arguments. Also, I have urged insurers to consider the possibility of providing health-related cash values.

Mr. Goodwin's disclosure to the readers of *Contingencies* that he offers life settlements for a profit is insufficient. The identity of each party in a secondary market transaction and the dollar amount of the financial interest of each party should be disclosed to the policyholder who sells his or her policy.

Mr. Goodwin asked if I have an "unrevealed financial interest." I have no financial interest, and would disclose it if I did. Anyone familiar with my 44 years of research, writing, and teaching would not ask that question, and ad hominem arguments do not advance discussion of the issues.

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Correction: In the photo on Page 20 of the May/June issue of Contingencies, *the person identified as Bridget Flynn is, in fact, Lisa A. Larsen. Our apologies to Lisa and Bridget.*