Insurance Times: Consumer Reports Cautions Buyers Of Life Settlements

January 23, 2001, Vol. XX No. 2

While Consumer Reports finds there are troubles,
the publication also finds the viatical industry fills a real need in helping critically ill and retired persons

Increasingly common insurance products, called viatical settlements or viaticals, allow for terminally ill insurance holders to get a percentage of their policy for immediate use. The word viatical comes from a Latin word meaning provisions for a journey. For some terminally ill patients and seniors, making these provisions requires money they don't have. Desperate times may call for desperate solutions, but for many terminally ill patients and the investors they attract, viatical settlements can compound their difficult situations, the magazine Consumer Reports says.

At first glance, viatical settlements look like the type of agreement in which both terminally ill patients and investors alike could gain, Consumer Reports says.

Terminally ill patients facing devastating medical expenses could sell an interest in a life insurance policy they own and with this settlement receive cash to help see them through their final days. Investors who became the beneficiaries of those policies would be rewarded with a tidy return from a sure bet. Such attractions are the wellspring of a growing business. In 1998, the 40 to 50 small companies that make up the industry exchanged about $1 billion in life insurance policies, up from just $50 million in 1991. Now the industry is moving to extend the marketing of viatical settlements to healthy seniors through so-called "life settlements," a market potentially worth $108 billion. Many viatical insiders believe that eventually Wall Street companies will sell shares in large pools of "used" insurance policies.

How It Works

A policyholder who can demonstrate that he has been diagnosed with a terminal illness will sell his policy to a settlement company for a fraction of its face value, depending on estimated life expectancy. The purchasing company later solicits investors. After the insured (or viator) dies and the insurance company pays off, investors receive their share of the claim.

Out of its portion of the investment, the viatical company pays premiums on the policy to keep it in force until the viator dies. In some cases, the company may require that investors or even viators pay the premiums. Any type of insurance can be used in a viatical settlement; whole life, universal, term, or group life. The viator must have owned the policy for a minimum of two years before he sells it.

However, Consumer Reports cautions that there are legal and ethical dilemmas involved. Insufficient consumer protection has left many viators with inadequate payments and investors stung after promised returns of up to as much as 30 percent fail to pan out. Fraud has been a common problem, prompting the North American Securities Administrators Association to name viaticals one of the top 10 investment scams of 1999, along with telemarketing schemes and get-rich-quick seminars.

Thirty-three of the 73 viatical companies Consumer Reports found in operation in 2000 had been in trouble with regulators in the past two years. Among their problems: failure to register with securities or insurance authorities, misuse of investor funds, misstatements about the medical condition of patients, and a fraudulent practice called "cleansheeting." Under that scheme, viatical companies solicit patients with life-threatening chronic or terminal conditions to lie about their health and apply for life insurance policies, which are then resold to investors.

But for all its troubles, Consumer Reports finds the viatical industry fills a real need in helping critically ill people pay for medical care. They could also help retired people who didn't manage to save enough for their old age.

Consumer Beware

Until state and federal regulators can establish the necessary safeguards, Consumer Reports advises that viators and potential investors can protect themselves by following these tips:

- Potential viators should investigate the alternatives before accepting a viatical settlement. They should check for early distribution provisions in the insurance policy. Also, they should explore borrowing from family and friends, using future proceeds from the insurance policy as collateral.
- Check first for companies affiliated with one of the two industry trade groups if a viatical settlement is their only option. The National Viatical Association (1200 G St., NW, Suite 760, Washington, D.C. 20005; 202-347-7361; www.nationalviatical.org); or the Viatical and Life Settlement Association (2025 M St., NW Suite 800, Washington, D.C. 20036; 202-367-1136; www.viatical.org) can verify a company's credentials. They should also check with local insurance regulators and get bids from several companies before accepting an offer.
- Consult with a financial advisor before signing over a policy. Collecting a viatical settlement can disqualify a patient from Medicaid benefits. Settlements paid to those with less than two years to live are free of federal taxes.
- Exercise extra caution before going the viatical route. Due to lack of regulation viators have no protected right of privacy and may be subject to a hefty tax bill.
- Don't accept less than the cash value for a whole-life policy.
- Investors should approach viatical settlement investments with great caution, as they are high risk-investments that could take years to pay off.
- Do not use this type of investment for Individual Retirement Accounts. IRA holders must start withdrawing funds no later than April 1 of the calendar year after they turn age 70 1/2. If the cash isn't there, they will face a penalty equal to half the sum they were required to withdraw but didn't.

The February report on viatical settlements, "Betting on Death," was to be posted online at www.ConsumerReports.org as of January 10. The February issue of Consumer Reports will be available on January 16 on newsstands.