

# Will History Repeat Itself?

by Paul F. Kirsch, Esq.

Remember the class action suits against the life insurance industry in the early 1990s? Life insurance carriers may want to forget paying out more than \$6 billion to settle claims alleging unfair or deceptive conduct based on inadequate or inaccurate disclosure.

The rise of the secondary market for the sale of life insurance policies is raising a number of similar questions that need to be addressed by life insurance carriers, their broker-dealers, and their licensed producers.

Will the failure of some prominent insurance carriers to inform policyholders about the life settlement market spawn a new area of consumer-based litigation? Will carriers be accused of unfair trade practices for prohibiting (and threatening) producers against advising clients about the secondary market? Are these carriers going to repeat their mistakes and allow the plaintiffs' bar another bite at the apple?

The concept underlying life settlements is not new. There are cases on record from more than 150 years ago. Similarly, insurers have recently offered accelerated death benefit riders (ADB), which permit terminally ill policyholders to access some value in their policies to defray the cost of medical treatment.

A life settlement is simply a financial planning alternative for policyholders to receive the real value in their insurance policies. The essential distinction between life settlements and cash-surrender values or ADBs is that life settlements give consumers the market value of their life insurance policies.

In Wharton's recent study, "The Benefits of a Secondary Market for Life Insurance Policies" (<http://fic.wharton.upenn.edu/fic/>), the authors concluded that, during calendar year 2002, life-settlement providers paid approximately \$340 million to acquire life insurance policies with a collective cash-surrender value of roughly \$94 million.

Policyholders who got the information

about the life settlement market received nearly four times as much value for their policies as they would have received had they been deprived of this information. Imagine the reaction of a plaintiffs' attorney.

## Consider the Following Scenarios:

• **Scenario 1** — As you are about to retire you have a \$1 million term life insurance policy that is due to have a dramatic increase in premiums. For any number of reasons, you have concluded that you no longer need or can no longer afford to maintain the insurance coverage. You explain your predicament and seek guidance from your life insurance agent, who is now "your financial services advisor." Upon the express directive of his insurance carrier or their broker-dealer, your financial advisor intentionally fails to tell you that there are life settlement providers that might be willing to pay as much as \$200,000 to purchase your policy. Without this critical information, you simply allow your policy to lapse. Would you feel that your financial advisor (and his or her broker-dealer) had breached an obligation to you to disclose certain material benefits associated with your policy, which resulted in a \$200,000 loss to you?

• **Scenario 2** — Your business has a \$5 million policy on your life that had been required by the bank. The business is being sold, so you determine that you no longer want to continue the premium payments. Moreover, your health has deteriorated and you can no longer purchase insurance with the same rate class. In reviewing the options, your agent suggests that you can surrender the policy for the \$249,000 of cash value or take a reduced paid up policy with a \$530,000 death bene-

fit. Regrettably, the insurance carrier has strictly prohibited your agent from advising you that, alternatively, you could sell your policy to a life settlement provider and receive \$1.2 million in cash. Without this information, you surrender the policy for the \$249,000. Subsequently, you learn that you lost approximately \$1 million due to the lack of disclosure. Would you feel that this agent and carrier had breached his or her ethical and legal duties owed to you?

Now, suppose that you are on a major life insurance carrier's board of directors. At a board meeting, you are asked to consider these two scenarios and provide responses to the same questions. During the meeting, you are reminded that your company has been a fervent supporter of the Insurance Marketplace Standards Association (IMSA) and frequently trumpets its participation in the organization. You are aware that, as a supporter and participant in

IMSA, your company has committed to abide by IMSA's principles and codes of business conduct. Principles number one and number two are as follows:

1. To conduct business according to high standards of honesty and fairness and to render that service to its customers which it would apply to or demand for itself in the same circumstances.
2. To provide competent and customer-focused sales and service.

Your company's legal advisors remind you of the statutory obligations that state legislatures imposed on insurance providers and their licensed producers to uphold their fiduciary duties and to disclose material information to consumers.

California's Unfair Competition Law (UCL), codified at California Business and Professions Code § 17200, et seq, expressly



prohibits “any unlawful, unfair, or fraudulent business act.” California courts have held that the test of whether a business practice is unfair involves an examination of [that practice’s] impact on its alleged victim balanced against the reasons, justifications, and motives of the alleged wrongdoer.

In brief, the court must weigh the utility of the defendant’s conduct against the gravity of the harm to the alleged victim (citations) (“...” *Podolsky v. First Healthcare Corp.*, 50 Cal.App.4th 632; *State Farm Fire & Casualty Co. v. Superior Court*, supra, 53 Cal.Rptr.2d 229.) Simply put, “unfair” means any practice whose harm to the victim outweighs its benefits. (*Saunders v. Superior Court*, 33 Cal.Rptr.2d 438).

As a member of the board of directors, would you be concerned about the prospects of class-action litigation because of your company’s express directive that prohibits agents from discussing the life settlement option with their clients? Based on the UCL principles and their interpretation by the California courts, would you be concerned that your company’s reasons, justifications, and motives for engaging in this business practice would be outweighed by the gravity of the harm to the clients?

Life insurance carriers, broker-dealers, and their licensed producers are being forced to confront these issues on a daily basis. Although there seem to be easy answers to the questions posed in these scenarios, surprisingly, many insurance companies have ignored the obvious. There are still a number of carriers and broker-dealers who strictly prohibit their licensed producers from advising clients about the benefits associated with life settlements. How these carriers and broker-dealers reconcile this position with the IMSA principles and the statutory obligations imposed on the industry is a question that the courts may answer.

The concept of “customer focused sales and service” clearly appears to require disclosure of a life settlement option. Furthermore, insurance carriers would be hard pressed to demonstrate how the utility of failing to disclose this fundamental information to clients outweighs the severe economic harm inflicted on uninformed policyholders.

Before some in the life insurance industry decide to disregard the interests of their customers, they might be well served to recall the liabilities incurred as a result of prior anti-consumer behavior, and ask one further question — Is it worth it?

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