



# “On The Money Report”

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By Steve Pomeranz, CFP

Host, *On The Money!* WXEL 90.7 FM

Another wonderful report from our Insurance expert, Randy Shine.....

-----Steve P.

## LIFE SETTLEMENT SCAM

BY  
RANDOLPH J. SHINE, CFP, MBA

*PSST., BUDDY. YOU WANT TO MAKE A FAST BUCK? GUARANTEED?*

The Pitch: Buy this life insurance policy and in two years, after the contestability period, you will be able to sell it, at a big profit, to a life settlement company. If you want, I will find you a bank that will finance it, so you won't have any out of pocket cost.

Like all good scams, it has to be restricted to a “select” group. In this case, those over 65, who are wealthy and have a trusted advisor.

Unfortunately, this pitch will not be from a stranger. It will be coming from a trusted advisor you have known for years, like your CPA, life insurance agent, or attorney.

This unethical, immoral and illegal scam is growing like a bad cancer here in south Florida. And it just took a turn for the worse.

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About two weeks ago a Boca Raton attorney sponsored a continuing education program for CPAs. At the seminar there was a life settlement company that made a pitch to the CPAs as follows. (This is a summary of what I was told from an attorney who is also a CPA and a CPA who was there.)

“We are asking you to send us your older (over 65 and preferably over 70) wealthy clients, so we can show them how they can make a lot of money in a short span of time. Your clients will purchase a life insurance policy, and after the two year contestability period, the life settlement company will buy it from them at a profit to their clients. They will not have to lay out any money because we can get banks to finance the transaction.”

“The reason you might want to help us is because, besides helping your clients make a lot of money, we will share the commissions/ fees with you, their trusted advisor. Until next October, you can receive these commissions/fees without having to become licensed as an insurance agent.” (I do not know what will be happening in October 2006 that will change the situation, but that is the date they gave.)

I know that just because something is unethical, immoral and illegal, that will not detour some individuals and advisors from jumping on this program, The fees are just too appealing. A “trusted” advisor stands to make \$5,000 to \$50,000 and more per client that signs up for this program. The insurance agent stands to make a lot more than the trusted advisor.

As with all scams, this program cannot work as advertised unless one of two things happen:

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1. The insured lies on the application. (Fraud.)
2. Within the two year period, the insured’s health deteriorates to such an extent that his/her life expectancy drops by 40% to 50%.

### Fraud:

When you fill out a life insurance application, both the insured and the agent have to sign off on the reason the policy is being purchased. Normally it would be for estate tax planning, family income needs, business continuation planning or some other legitimate insurance purpose. You commit fraud if you misstate the true purpose of purchasing the life insurance. The agent is also participating in the fraud.

You can get around committing this particular fraud if you state something like: “plan to sell the policy after two years so I can make some money”. (Of course, if you did this, the insurance company would not accept the application, but that is another issue.) It has gotten so bad that on some of the newer life insurance applications the actual question: “do you plan on selling this policy in the future? Yes or No.” is asked.

Why the scam cannot/will not work as advertised: A little common sense.

This scheme can only work if the life insurance policies are not being underwritten and priced correctly. That is not going to happen.

The Life Settlement industry is a needed and necessary business. Their business is to purchase life insurance policies from individuals or trusts that can no longer afford the premiums, or no longer need or want the insurance. The life settlement industry tries to make 12% to 15% annual return on their investment. They use professional, highly skilled underwriters to evaluate how much they should pay for a policy. It is based on the life expectancy of the insured and the cost of future premiums in order to keep the policy in force until the insured dies.



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Let us assume one did not lie about their medical condition or the purpose of the life insurance, and a policy was issued. Life insurance underwriters are highly skilled, well trained professionals. They base their life expectancy figures on in-depth research and thorough review of the application, to calculate the correct pricing based on the individuals age, sex, health, lifestyle, and other relevant factors. It is not a wild guess.

Underwriting life insurance is an art as well as a science and therefore the amount of money that will be offered for a given policy can and will vary from company to company. That is why it is always a good idea to get more than one offer when shopping to sell a life insurance policy. There may be a 10% to 15% difference in pricing: not 50% to 100%.

Question: What must happen to the insured’s life expectancy by the end of the second year to make the policy attractive enough that a life settlement company will make an offer that will allow them to make 12% return on their investment and the owner make a profit at the same time? The insured’s life expectancy will have to considerably change for the worse – become shorter by a factor of 40% or 50% or more for the sale to work.

### An example: A true case.

Bill is 77 and has some health issues. He is the prime target for this scam. Bill’s life insurance agent, whom he has known for years, pitched Bill this very scheme. He proposed Bill purchase a \$5.5 million policy on his life with an annual target premium of \$350,000. Bill’s agent said he would only have to fund the premiums for two years. After two years his agent would arrange for Bill to sell the policy to a life settlement firm for \$1.4 million. (None of this is in writing)



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This policy, when issued would have an embedded life expectancy of about 11 years for Bill, as a standard insured. The cash value after two years would be about \$175,000 and there may be surrender charges.

If Bill’s health is unchanged, no legitimate life settlement firm is going to offer to buy Bill’s policy for \$1.4 million. Why? Because to do so would only provide the life settlement firm with about a 1.2 to 1.3 percent return on investment. Bill’s life expectancy would have to fall a minimum of four years, because of a new health issue, for someone to consider offering \$1.4 million for the policy.

Now for the real kicker! If the insured’s health does deteriorate more rapidly than what is standard for a passage of time, in this case two years, the owner of the policy would be better off keeping it rather than selling it.

If Bill has a standard-rated policy bought two years before, and his life expectancy dropped by four years, at age 79, it is in Bill’s interest to retain the policy himself. Bill’s family could earn the 12% to 15% return on the investment that the life settlement company plans on making from purchasing the policy.

### Unethical:

The prime directive in the code of ethics for CFPs and insurance agents is: Your client’s welfare comes first in all matters. Their needs before your needs. Client first.

I cannot understand how someone can induce their client into a fraudulent scheme that doesn’t stand a chance of working, and claim they are putting their client’s welfare first.



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If someone approaches you to participate in this scam, run, don't walk, the other way. You now know you are dealing with an unethical person who puts his/her own greed before all else. I suggest, no, I request, that you report that person, and the company the person works for or represents, to the insurance commissioner. Help protect your friends and neighbors by telling them about this scam and the scammer you know.

---Randy Shine, CFP

For more info, contact:

Shine Financial Inc.  
1191 E. Newport Center Dr.  
Suite 107  
Deerfield Beach, FL 33442  
Shinefinancial.com  
954-428-4007