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Late in Life, Finding a Bonanza in Life Insurance

By CHARLES DUHIGG

Marvin Margolis, an 80-year-old Manhattan financial consultant, is looking for investors willing to bet on when he will die.

Two years ago, Mr. Margolis bought a large life insurance policy. Now, he's considering selling it to a group of investors, a deal that should give him as much as $2 million to enjoy in his final years. In return, the investors will get the policy's $7 million payout when he dies — which they hope will be soon, so they can stop paying his premiums.

"This is a wonderful opportunity to use my body as an asset," Mr. Margolis said. "I deserve to be able to benefit in some way from my age."

Trading in life insurance policies held by wealthy seniors has quietly become a big business. Hedge funds, financial institutions like Credit Suisse and Deutsche Bank, and investors like Warren E. Buffett are spending billions to buy life insurance policies from the elderly. Other investors are paying seniors to apply for life insurance, lending them money to buy the policies, and then reselling them to speculators.

This nascent market illustrates one way that investors are hoping to make money from a large and wealthy generation of Americans as they reach retirement age. These aging baby boomers and those even older offer both opportunities and risks for many companies, investors and swindlers seeking to capitalize on their final years.

Insurance executives, for instance, say transactions like Mr. Margolis's may cripple their industry and make it harder for the average senior to buy life insurance in the first place. Insurers are worried because they count on many customers canceling their policies before they die, usually because their children grow up and no longer need the financial protection, their pensions kick in or premiums become too expensive. If far more policies result in payouts, the insurance business becomes much less profitable.

Indeed, industry analysts say they expect the cost of life insurance to rise as companies prepare to pay out more claims.

“If payouts increase, the cost of insuring people is effectively going up, and that will definitely increase the price of policies,” said J. David Cummins, a professor at the Wharton School of the University of Pennsylvania.

While that may be the case, many people have come to rely on selling their policies to provide urgently needed money for medical care and living expenses when their bank accounts run dry. However, insurance executives say that the market that has emerged could be ruinous.

“Life insurance is a way for individuals to protect their families,” said C. Robert Henrikson, the chief executive of MetLife. “If someone profits from a stranger’s death, it stands the whole purpose of life insurance on its head. Anything that disrupts the economic processes underlying this industry will drive the cost of life insurance through the ceiling.”

Policies like Mr. Margolis’s cause particular concern. It was originally paid for with a loan from speculators who will get their money back, plus a profit, if it is sold to another group of investors, according to public documents. Even if Mr. Margolis does not sell, the loan will be repaid from the death benefit when he dies.

Such policies are known as speculator-initiated life insurance, or “spin-life” policies. Investors estimate that spin-life policies worth as much as $13 billion will change hands next year.

The deals are so lucrative that older people are being wooed in every fathomable way. In Florida, investors have sponsored free cruises for seniors willing to undergo physical exams and apply for life insurance while onboard.

For insurers, such cruises are a financial Titanic. Over the next decade, the insurance industry could be forced to pay out unexpectedly more than $100 billion in death benefits as spin-life policies come to maturity, investors estimate.

In Minnesota, according to lawsuits brought by insurers, an 82-year-old named John R. Paulson bought life policies worth $120 million from seven companies and resold many of them before insurance companies realized what was going on and sued, saying that Mr. Paulson had lied on his applications.

Life insurance companies, in particular, rely on policies lapsing before the policyholder dies. Last year, for instance, insurance companies reduced their financial exposure by $1.1 trillion when 19.8 million policyholders stopped paying premiums, according to the Insurance Information Institute. In comparison, the industry paid death benefits on only 2.2 million policies.

If those lapsed policies had been sold to investors rather than canceled, insurance companies could have eventually paid out as much as a trillion dollars, say analysts.

In an attempt to mitigate such risk, some insurance companies are trying to make policies for seniors harder to buy. The biggest insurer in the United States, American International Group, earlier this year increased prices on some universal life policies for buyers more than 70 years old in an effort to thwart spin-life deals.

“We don’t want this business, and we’re taking steps to discourage those purchasers from coming through our doors,” an A.I.G. spokesman said.

But such moves may be too late. The market for purchasing life insurance policies from seniors is an outgrowth of the so-called viatical industry that began in the 1980s, when investors bought up life insurance policies of AIDS patients. In the last two years, as interest rates and stock market returns have declined, the number of buyers seeking seniors’ policies has soared.

That growth was fueled this year when the Financial Accounting Standards Board issued rules permitting investors to record purchases of policies immediately as a profit, rather than forcing them to wait until the policyholder died.

Critics contend the industry punishes the young and healthy, by driving up prices, but many people who have sold their policies say it offered their only way to avoid calamity.

“If I hadn’t been able to sell this policy we would have lost our house, all of our savings, everything,” said Andrew Schneider of Kaysville, Utah. Seven years ago his wife, Karen, learned she had breast cancer. Her expenses exceeded the Schneiders’ medical insurance by half a million dollars. Mrs. Schneider sold her life insurance policy for about $250,000 and used the money to buy medicine and pay bills, he said. The investors who bought her policy received a $500,000 death benefit when she died last year.

“Selling that policy extended her life for years,” said Mr. Schneider. “If this market hadn’t existed, we would have become financially destitute.”

Finding enough life insurance policies to satisfy investor hunger has proved difficult. So, in addition to the free cruises in Florida, investors including one large hedge fund have hired a California telemarketing company to call elderly citizens and ask if they would apply for life insurance in exchange for a paycheck.

The insurance industry has begun to fight back. Legislatures in New Jersey, New York and nine other states have proposed laws intended to outlaw spin-life investments or make it more difficult for investors to get payouts, according to the Life Insurance Settlement Association.

Insurance companies have also sued to cancel policies, contending that payouts benefiting outside investors violate the legal requirement that beneficiaries have an "insurable interest" in the policyholder's life.

But many advocates for the elderly and industry insiders worry that seniors will lose their legitimate ability to sell life insurance policies they have held for years.

"We've put billions of dollars in the hands of seniors who were getting thrown out of their homes or needed medication, and their only asset was a life insurance policy," said Scott Page, chief executive of the Lifeline Program, a company that helps investors buy life insurance policies from the elderly and infirm. "If you make it harder to sell these policies, you're taking money out of the hands of people who have nothing else."

Another risk is that seniors hoping to sell their life insurance policies will be stuck in bad deals. In October, the New York attorney general, Eliot Spitzer, filed a lawsuit accusing one life insurance speculator, Coventry Financial, of bid-rigging and other fraud in acquiring more than $3.6 billion in life insurance policies. Coventry said it would fight the suit.

A lawyer who has helped the elderly set up spin-life arrangements worth more than $300 million said that often the terms of the deals prevented his clients from profiting.

"Investors say, 'I'll loan you money to buy a new policy, and in a few years I'll buy it from you,' " said Larry Brody, a partner at the law firm Bryan Cave. But a few years later, when the seniors sell the policy, they owe so much in interest and fees on the loan, he said, "it eats up all the profit. And what's more, they can't buy another insurance policy, because insurers are unwilling to give them more coverage."

But those risks are worth the trouble, according to some buyers and sellers. In 2004, Irene Randall, a life-settlement broker in Albuquerque, N.M., set up an $8 million spin-life policy for her 82-year-old uncle with investors who agreed to lend him money for the premiums. In return, she said, the company hopes to buy the policy next year, paying her uncle $1.5 million.

Ms. Randall called it a great deal and said she was setting up a similar arrangement for her 82-year-old mother. She expects both her mother and uncle will live long enough to enjoy the windfall. "The one thing we know is that everyone is going to die at some point," said Ms. Randall. "If someone is willing to pay you because you're old, why not try and live it up before then?”

Jenny Anderson contributed reporting.