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Life Settlements — Selling A Life Insurance Policy: Advising Your Clients

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1. Problems with the life settlement market

    a. High transaction costs
    b. Lack of transparency
    c. Valuation mistakes
    d. Loss of privacy
    e. Lack of uniform regulation
    f. Uncertain tax treatment

2. How to avoid leaving money on the table

    a. Retain the policy as an asset for the beneficiaries
    b. Retain the policy for a future sale
    c. Retain a portion of the policy
    d. Obtain an independent appraisal
    e. Set up a bidding process that will benefit your client
    f. Negotiate the life settlement broker's commission

3. Methods for retaining the policy

    a. Pay premiums out of pocket or from another source (beneficiary, loan from insurance company or third-party lender)
    b. Use cash value to cover monthly charges
    c. Reduce the death benefit

4. How to value a life insurance policy

    a. Necessary documents (verification of coverage (VOC), inforce illustration, contract, annual statement, life expectancy evaluation reports)
    b. What are the cash flows?

5. How to set up a bidding process

    a. Use one or more brokers, an online auction, or go directly to providers or funders?
    b. What are the provisions of the broker's contract (exclusivity, disclosures, commissions)?
    c. How many rounds of bidding?

Overview of the Life Settlement Market

Average purchase price	10% to 30% of death benefit
Number of transactions	> 5,000 per year
Average policy size	> $1,000,000
Insured's age	> age 65
Life expectancy	2 to 20 years
Type of policy	Universal life, convertible term, variable universal life, whole life Single life, second-to-die with one or both insureds alive
Licensing	Varies by state

The Life Settlement Process

Policyowner	
Agent	Finds policyowners who are interested in selling their policies. May deal with life settlement providers directly or work with a broker.
Life settlement broker	Represents the policyowner. Gathers medical records and obtains life expectancy evaluation reports. Negotiates with life settlement providers to obtain purchase offers.
Life settlement provider	Represents investors. Obtains life expectancy evaluation reports. Analyzes policy and makes purchase offer. Handles policy administration after the sale or subcontracts with a service provider.
Funder	Provides capital to buy the policy.

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The Life Settlement Market: Who Gets What

Example: Universal life policy

$1,000,000	Death benefit
$400,000	Value to beneficiaries (retention value, intrinsic economic value)
$200,000	Purchase price before tax
$50,000	Cash surrender value
$150,000	Cost basis

Does a life settlement create or destroy value?

$400,000	Value to beneficiaries
$280,000	Funder's offer
(30,000)	Provider's fee (1% to 3% of face amount)
$250,000	Gross offer
(50,000)	Broker's commission (up to 6% of face amount or 30% of gross offer), shared with referring agent
$200,000	Net offer (purchase price before tax)
(7,500)	Income tax (15%)
$192,500	Purchase price after tax

Two perspectives on life settlements			
$192,500	Purchase price after tax	$192,500	Purchase price after tax
- 50,000	Cash surrender value	- 400,000	Value to beneficiaries
= $142,500	Value created	= $(207,500)	Value destroyed