Life Settlements

Buckeye Life Resources

Life settlements overview

A life settlement is the sale of an existing life insurance policy to a third-party investor for an amount greater than its cash surrender value, if any, but less than its face amount. The seller transfers ownership of the policy to the buyer in exchange for an immediate cash payment (at times, the seller may also retain a portion of the death benefit). In turn, the buyer of the policy pays all future premiums to keep coverage in force and then receives the net death benefit when the insured passes away.

The life settlement industry (or secondary market for life insurance) dates back more than a century in the United States, at which time the Supreme Court concluded life insurance is personal property that may be sold or assigned not unlike other assets. Even though the legal basis for life settlements was determined long ago, the industry has taken shape only during the past couple of decades.

Reasons to sell

Life insurance is an important financial tool that serves many purposes, affording its owners and their dependents invaluable peace of mind in the event the unexpected happens. By the time most people reach the age of 70, however, the original reason that motivated them to purchase life insurance no longer exists. What's more, the cost of life insurance only climbs as we age to reflect our increased mortality, making premium payments increasingly burdensome through the years. This may explain in part why the vast majority of life insurance policies never pay a claim – most owners eventually surrender their policies or simply allow them to lapse.

In lieu of forfeiting one's life insurance policy to the issuing carrier for comparatively little or nothing in return, a life settlement may enable the policy owner to extract considerably more value for his or her asset and use the sale proceeds in unlimited ways.

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Common Uses of Sale Proceeds

Income	Enhance retirement
Investment	Diversify holdings
Gifts	Help family members
Philanthropy	Support charity
Long term care	Improve the quality of care
Bucket List	Fulfill dreams

Case viability

There are no definitive guidelines dictating whether or not a given case is marketable (industry participants refer to life settlement candidates holistically as "cases"). Many different factors apply, and no two cases are identical. Here are basic criteria and characteristics that generally render cases more saleable, however:

Insured

Age	Above ~ 75 (younger with health issues)
Life expectancy	Below ~15 years

Policy

Type	Universal Life & Term Conversions
Death benefit	Above ~$200,000
Issue date	More than 2 years ago

Even if a case violates one or more of the rules of thumb cited above, it may still be appealing to buyers depending on the overall circumstances. Life settlement evaluation is an inexact science, and investors differ from one another along lines of risk tolerance, underwriting criteria and buying preferences.

How pricing is determined

Buyers decide what they're willing to pay for a policy in today's dollars based on what they believe it will cost them to keep the policy in force until they collect the death benefit at some unknown future date. Will the total amount they spend to buy and then fund the policy enable them to realize an acceptable investment return?

The primary drivers of policy value are as follows:

Policy Cost	***Insured's Life Expectancy***
Life insurance policies vary widely in terms of the premium payments required to maintain coverage over time. Less costly policies are more appealing to buyers than costly ones.	How much longer the insured is expected to live is pivotal because it dictates the duration of the investment and impacts the sum needed to keep the policy in force after the sale.
Buyers' Returns	***Competition***
Like most investors, life settlement buyers seek investment returns commensurate with the risk they face. At the same time, they must adhere to prevailing market conditions.	Not surprisingly, life settlement investors strive to pay as little as possible for policies. As such, sellers won't obtain fair market value offers unless multiple bidders compete against one another, thereby driving up offers.

The life settlement process

As with real estate and other significant assets, selling a life insurance policy in the secondary market is usually a lengthy and arduous process because it involves extensive due diligence on behalf of buyers and other parties to the transaction. In effect, investors spend considerable sums of money to buy and then fund an intangible asset in return for a payout at some eventual date, perhaps as distant as fifteen or more years. It's therefore imperative for buyers to gain assurance from legal and other perspectives that all facets of the transaction are handled properly so the investment won't be jeopardized.

Here's a summary of the process, which usually takes from 3-6 months to complete:

PQ	→	Development	→	Auction	→	Closing	→	Funding
(<2 weeks)		*(3-8 weeks)*		*(3-4 weeks)*		*(3-6 weeks)*		*(2-4 weeks)*

Prequalification

The first step is for the policy owner to determine who will advise and represent him or her throughout the process. Among other individuals, this may be a financial planner, life insurance agent, estate attorney and/or life settlement broker. Aside from being knowledgeable about and properly licensed for life settlements, whoever is selected should be capable of prequalifying the case from the onset to accurately gauge its marketability and potential value. This matters because it will help to establish realistic expectations or avoid wasted time, effort or money by those involved.

Case development

To consider bidding on a case, prospective buyers require various policy- and health-related information for evaluative purposes. The seller's advisor handles all such matters but needs written authorization from the policy owner and insured to do so. In-force policy illustrations and other information will be obtained from the carrier, as well as medical records from the insured's health care providers (followed by third-party life expectancy reports). In particular, the medical records and life expectancy reports add notably to the overall duration of the process – possibly up to two or more months – in part because they can't be gathered concurrently.

Auction

Once a complete case is assembled, all pertinent documentation is shared with potential buyers for their analysis and bidding. It's in the seller's best interest to approach only licensed and institutional buyers, and it's critical to market the case to as many of them as possible in an effort to maximize offers for the policy. A fiduciary-minded advisor's goal during this phase should be to conduct a thorough and systematic auction that isolates the highest bidder.

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Closing

Assuming the seller accepts the winning offer, the case enters the “closing” phase, during which the prospective buyer issues formal contracts and related documentation for review and completion by the seller. Closing is another time-intensive part of the process because the buyer and its representatives scrutinize all aspects of the transaction for accuracy, leaving no unresolved issues that may stand in the way of a proper and legal transfer.

After the buyer is satisfied with its review, the funds allocated for the purchase are released to third-party escrow, and the escrow agent submits the change of ownership and beneficiary forms to the insurer. Finally, the seller’s proceeds are issued within three days of the noted changes.

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