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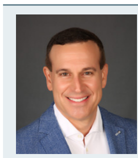
By **Jon B. Mendelsohn**

FINRA Bulletin Uncovers Blind Spots for Wealth Managers About Life Settlements

What are the risks you need to discuss with your clients?

As an estate planner or investment advisor, you may be faced with a client who asks you for advice about considering a life settlement for their insurance policy. A life settlement is an option for a policy owner to sell and exchange their life insurance policy for a lump sum payment that's higher than the cash surrender value and less than the death benefit. All policy types can qualify, including term. However, participating in a life settlement comes with risks, as detailed in a July 31, 2023 bulletin by the Financial Industry Regulatory Authority (FINRA).[1] Although this bulletin is targeted at broker-dealers and registered investment advisors (RIAs), all wealth advisors, attorneys and tax professionals can benefit from the information it provides. The FINRA bulletin warns that life settlements aren't for everyone and that policy owners should be wary of high pressure sales tactics and aggressive advertising. Although the life settlement market is highly regulated, the process can be opaque for clients and their trusted advisors. Clients could potentially receive much lower offers than their policies are worth. The bulletin also advises policy owners to engage a representative to "shop around." It notes that this can include "contacting multiple life settlement companies, using a licensed life settlement broker who will shop your policy around on your behalf, or contacting your investment professional or other financial services provider."

You can help your client figure out if a life settlement is the right step for them and what risks may be involved in this course of action.



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Client Expresses Interest

Say your client asks you about a $2 million guaranteed universal life insurance policy issued 15 years ago. The policy is individually owned by the client with the purpose of providing income for their surviving spouse, paying off debts and other planning needs. The client mentions that they and their spouse would rather spend this money elsewhere. They don't want to keep paying into the policy and would rather receive a buyout and lump sum today. The client asks about the possibility of doing a life settlement. You want to ensure that you do the right thing, protect the client, and are insulated from liability as their advisor.

Three Key Stages

Before you can help your client evaluate whether a life settlement is right for them, you should understand the three stages of the life settlement process:

Stage 1. Discovery and indication of value. The life settlement broker or agent gathers information and communicates the anticipated range of value. No medical exam is required. The insured and policy owner complete state-approved authorizations that allow information to be obtained from the carrier and medical facilities. The agent or broker aggregates life insurance carrier documents and the insured's medical records, obtains life expectancy estimates used in their modeling and then reviews them to discuss a reasonable range of value based on comparable policy sales. If the range is acceptable, policy ownership documents are aggregated.

Stage 2. Life settlement broker or agents facilitate a policy auction to generate offers and determine the fair market value. There will be bidding rounds with offers and counteroffers, as well as discussions about contingencies related to the

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offer and associated timeframes. As a fiduciary, the broker or agent conducting the policy auction will document price discovery and best practices for record keeping. This step is critical for fiduciaries so they can prove that they looked out for the client's best interests. The policy owner determines if they'll accept or decline the offer.

Stage 3. Contracting and rescission rights: If the policy holder accepts the offer, the life settlement broker or agent reviews and prepares contracts to be signed, assesses all contingencies, reviews the transactional summary and disclosure requirements and performs all state reporting requirements. The policy owner is paid the purchase price from escrow. Most states have a 15-day rescission period for the policy owner to exercise if they decide to unwind the transaction.

Here are some other facts to know about life settlements:

- They're available in all states, and most states started requiring life settlement licensing under the life insurance license during the early 2000s. Many of the nation's largest broker-dealers and RIAs have participated in life settlements when retirement-age clients exit their life insurance.
- To qualify for a life settlement, policies must be past the 2-year contestability and suicide period.
- In regulated transactions, due diligence and fraud checks are standard requirements.
- Like real estate, documenting a clean title is critical during contracting to confirm the purchaser owns the policy free and clear of any debtors, previous business partners or divorce decrees.
- All fixed products (universal life, term, whole life, single life and survivorship) may be transacted through licensed entities. Since 2009, variable life settlement must be facilitated through a FINRA-approved broker-dealer.[2]

Evaluate Existing Policy

Before moving ahead with the life settlement, compare how the client can benefit by keeping or restructuring the life insurance policy. The client should review the policy to understand the policy values and the premiums necessary to keep the coverage to maturity. As clients are living much longer these days, especially wealthier clients who have access to better health care, they need to know the cash requirements to keep the policy into their 90s or past age 100.

To restructure the policy and consider keeping it to a targeted age or seeing if others in the family feel the investment of more premiums is worthwhile, the client should ask for a comprehensive review of current illustrations to understand how long the policy will last without additional premiums. The client should find out how much premium reserves should be expected to keep the policy to age 90, 95 and past 100. If the insured lives longer than the specific target age, what are the catch-up premiums moving forward once the cash value is depleted? The client should also research what the premium would be if the death benefit was reduced by 25%–50% to maintain coverage. Lastly, there should be a conversation related to the insured's health and health care costs that the policy owner and related parties need to be aware of, as this could affect future cash flow requirements.

Finding a Reputable Company

If the client decides to move ahead with the life settlement, they should find a company to help with the process. But as the FINRA bulletin warns, not all companies are the same. Some states have licensing requirements for these companies, and some may have a record of complaints against them. The bulletin warns policy holders to be extremely wary of life settlement companies and brokers with a history of complaints or regulatory infractions.

There are only two licenses for life settlements. A licensed life settlement broker has a fiduciary duty to the policy owner, and their process should be centered around the best interests of the client. A licensed life settlement provider represents the investor and maximizes returns for the buyer. A recent entrant to the life settlement market is lead generation companies that sell information to life settlement companies.

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Here are some questions you should encourage your client to ask about the life settlement company they're considering:

- Are you licensed to represent the policy owner or the buyer?
- Does your company benefit from the client receiving a higher or lower offer? How does your company generate revenue?
- Do you buy policies on behalf of investors or facilitate price discovery through an auction process forcing multiple providers to compete against each other?
- Are you licensed in the state of the policy owner? Or, are you a lead generation marketing company?
- How many life settlements have you managed from beginning to end? Is this a full-time or part-time part of your business?
- Do you disclose all life expectancy data so the client can make an informed decision?
- How many independently regulated buyers was the policy sent to, and are all offers disclosed?
- Do you share client data with any individual investors or only regulated institutional buyers?
- Have you or any of the principals of your firm ever been named in life settlement-related legal matters? Please disclose.

Getting a Fair Price

The FINRA bulletin explains that "one of the hardest things to know when you're selling a life insurance policy is whether you're getting a fair price." There's been a robust life settlement secondary insurance market for over 20 years. Life settlements have emerged as an asset class, attracting U.S., U.K. and European pension plans and global institutional asset managers. Just receiving more than the cash surrender value doesn't constitute a fair price if the offer could have been much higher. The average life settlement offers are five times greater than the cash surrender value.

As in most situations in life and business, follow the money. A policy auction forces competition among many independent providers that purchase policies, resulting in bids and counterbids until the auction ends. The buyer pays all future premium obligations and receives the death benefit when the insured passes. The more a buyer pays for a policy, the lower the return will be to the investor's fund in the next five to 20 years. Many view life insurance as a mortality bond with an undetermined maturity date. What if the insured lives 10%–50% longer than projected? How much more premium would the current owner or an investor be required to keep reserved? The policy owner should consider these issues prior to selling the policy.

> The number one factor impacting offers is the life expectancy data point.

The projected longevity of the insured impacts the life settlement offers for the policy. The more confidence that an investor has in forecasting the future premiums, the higher the life settlement offer. The number one factor impacting offers is the life expectancy data point. A life settlement broker has the responsibility to disclose all life expectancies. A life settlement provider that buys policies doesn't. Require transparency from whomever you're working with to disclose all longevity-related information.

How would a client feel if told they sold their policy for "fair value versus fair market value?" Leaving out the keyword "market" in the middle can make all the difference. It's the difference between one offer and competitive offers. Competition among providers buying policies minimizes the chances of seller's remorse or the risk of leaving money on the table. Which option would most policy owners choose?[3]

Endnotes

1. *www.finra.org/investors/insights/what-you-should-know-about-life-settlements.*
2. *See* Regulatory Notice 09-42.
3. For additional questions to ask regarding the life settlement, *see www.wealthmanagement.com/insurance/questions-advisors-should-ask-about-life-settlement-proposals.*

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