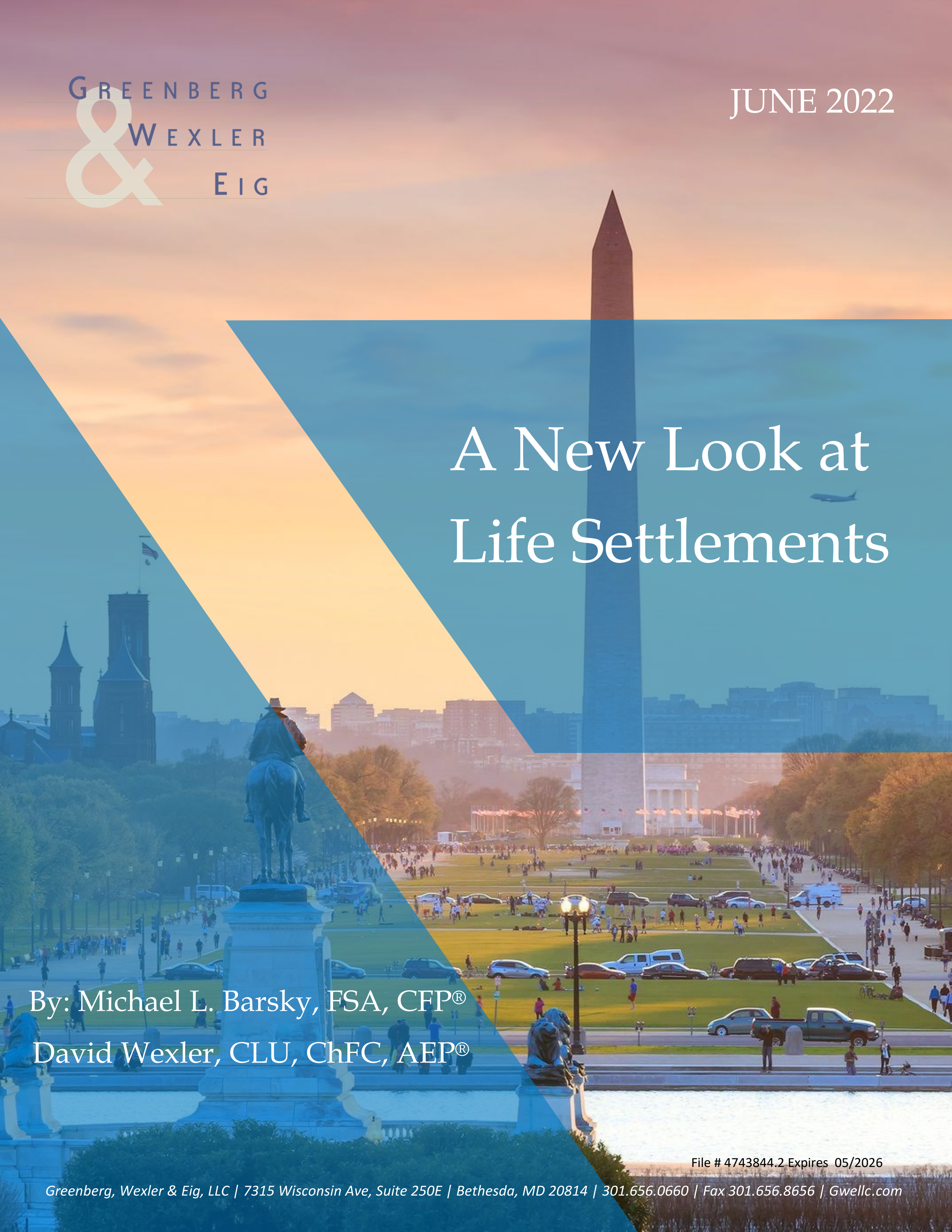

GREENBERG & WEXLER EIG

JUNE 2022

A New Look at Life Settlements

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File # 4743844.2 Expires 05/2026

INTRODUCTION

As an advisor, you may have heard that clients who have experienced a change in health can often sell their in-force life insurance policies, including term insurance, for amounts that exceed their cash surrender value.

However, you may be unaware that even healthy individuals who own certain types of policies may also be able to "settle" (sell) their policy.

Over the past few years, there has been a growing consumer awareness of life insurance settlements, which involves the sale of an existing policy to a third party for more than the policy's cash surrender value**.** You may have seen advertisements targeted directly to senior citizens from companies offering to buy their policies. The rationales usually are:

- Selling an unneeded policy offers an easy way to provide cash to supplement retirement or pay for medical expenses.
- Policies may have premiums that increase as the insured gets older.
- Many underperforming life insurance policies end before death, resulting in people losing out on their insurance payouts

This article addresses the background and history of life settlements, the key drivers of this trend, the life settlements process with two case studies, and the pros and cons of selling a policy. Trustees and trusted advisors should stay informed of these latest developments and trends, so that your clients are aware of all their options.

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BACKGROUND & HISTORY

Many people do not realize that a life insurance policy can be a very valuable asset, even if there is little or no cash value in the policy. This is particularly true if you are over age 65 and have experienced a decline in health.

In the early 20th century, a Supreme Court case (Grigsby vs Russell) certified the right for individuals to transfer ownership of their policy. Nevertheless, there was little activity in this area for the next 75 years. In the mid-1980s, there was increased interest in the sale of in-force policies due to the HIV/AIDS crisis. Patients could sell their policies to help pay for health care and hospice care. This came to be known as "viatical" sales, where patients had very short life expectancies. In some cases, policy owners received over 90% of the face amount. Ultimately, treatments improved, and settlement offers were reduced.

In 1996, the Health Insurance Portability and Accountability Act (HIPAA) made changes to the Internal Revenue Code, allow for early payments of life insurance policies to terminally ill patients to be treated in the same manner as if they were paid at death. A terminally ill individual is defined as "an individual who has been certified by a physician as having an illness or physical condition which can reasonably be expected to result in death in 24 months or less after the date of certification". Many companies added terminal illness riders to their policies to allow for early payment of death benefits, thereby removing the incentive for affected policy owners to sell their policies to a viatical company.

In the early 2000s, some individuals began to purchase new life insurance policies with the intention to sell the policy to an unrelated third party for cash. This became problematic, since state law requires that the person or entity initially purchasing a policy must have "insurable interest" in the person being covered. Fortunately, through increased regulation and oversight, this short-lived phenomenon of "stranger owned life insurance" was dissolved.

Nevertheless, when a policy is purchased for legitimate reasons but is no longer needed or wanted, it is perfectly reasonable for the owner to act in their own best interests and select a party who will provide the greatest financial renumeration.

File # 4743844.2 Expires 05/2026

KEY DRIVERS OF LIFE SETTLEMENT EXPANSION

In the past decade, there has been a substantial increase in life settlement activity. No longer is it necessary to have a terminal illness, but other conditions resulting in a diminished life expectancy can also create the opportunity for a settlement offer. Even healthy individuals who own certain types of policies may be eligible.

There have been several key drivers of this increased interest in life settlements:

- **Product Changes**
- **Tax Law Changes**
- **Increased Investor Interest and Sophistication**

Product Changes

There has been a shift in the types of products that insurance companies are selling. Up until the early 1980s, the main types of life insurance policies sold in the US were term and whole life. Term carries low initial premiums but can become very expensive in the later years. Whole life typically has level, guaranteed premiums. However, those premiums are relatively high compared to other forms of insurance available today. Also, whole life policies typically have substantial cash surrender values, which often match the reserve liabilities that an insurance company holds. So if a relatively healthy individual decides to terminate their whole life policy after it has been in-force for a number of years, the cash value is a close proxy to the economic value of the policy.

Starting in the mid-1980s, there was a shift away from whole life to Universal Life (UL). These UL products were more unbundled and offered increased flexibility with respect to benefits and premium payments. However, with this increased flexibility came the loss of a guaranteed death benefit and the potential for large increases in premiums later in life. A variation of this product is Indexed Universal Life (IUL), where the interest credited to the policy is tied to the performance of an outside index such as the S&P 500.

In the 2000s, some insurers began to market a form of UL known as Guaranteed Universal life (GUL). As with whole life, these products offered a guaranteed death benefit provided that all required premiums are paid on a timely basis. The major appeal is that the guaranteed premium rates are often less than half of a comparable whole life policy. However, unlike whole life, these GUL policies typically build up little or no cash values, even though the company needs to hold substantial reserves. So, if a policy owner later decides that they no longer want or need their policy, there may be little economic benefit by surrendering or lapsing the policy.

Life settlement companies are much more interested in purchasing UL and GUL policies than whole life. In particular, GUL policies offer the greatest protection to the buyer, as they can better control their costs if the insured lives longer than expected. Therefore, all things being equal, a buyer will offer more money for a GUL policy with fixed, guaranteed premiums than for a UL policy where the premiums can increase sharply.

Tax Law Changes

When a policy owner turns in their in-force life insurance policy for its cash surrender value, the excess of the amount received over the policy's "cost basis" is taxed at ordinary income rates. This cost basis is the amount paid into policy less previous nontaxable withdrawals. However, prior to 2017, if an in-force policy was sold to a third party, the owner's cost basis had to be reduced by the cumulative cost of insurance charges

In 2017, the Tax Cuts and Jobs Act put life settlements on an even footing with policy surrenders. The policy's cost basis now no longer reduced for cost of insurance charges. Further, the law clarified that any amounts received by settlor above the cash value would be taxed at favorable capital gains rates. Additionally, this law made several charges to estate and gift taxes. As a result, some people who purchased life insurance with the intention of paying eventual estate taxes found that they no longer need the policies for its originally intended purpose.

Increased Investor Interest and Sophistication

In the sustained low interest environment, many large institutional life settlements funds have emerged as investors seek out new opportunities for higher yields. This has led to increased capital available for life settlements and attractive alternatives to certain policy owners.

Investors that purchase policies have become much more sophisticated in their fund diversification strategies. They diversify by product, by condition, by life expectancy, and by carrier and rate of return. This has prompted some companies to extend their willingness to sometimes purchase policies simply based on age without the reverse medical underwriting that has been typical in the industry.

File # 4743844.2 Expires 05/2026

Life Settlements Process and Case Studies

At Greenberg, Wexler & Eig, we have two decades of experience in life settlements and can help policy owners leverage multiple offers and secure a competitive financial outcome for their policy. This usually results in a better outcome than owners going directly to just one potential buyer.

These are two phases involved with initiating and completing the life settlements process:

Appraisals through Policy Auction → **Completing the Settlement**

This stage typically takes from 2 to 8 weeks. The insured signs HIPAA forms, we order medical records and send out to prospective buyers. We then receive offers and negotiate to get the best possible offer.

At this stage, the buyer is chosen, and the contract is generated and executed. When settling a term policy, a conversion is usually made to a permanent policy. The owner and beneficiary are officially changed to the buyer, and money is sent out to insured

At Greenberg, Wexler & Eig LLC, half of the policies we have settled over the past 5 years were ***permanent/universal life***, and half were **term** policies. Here are some highlights:

	Minimum	Maximum	Average
Age at Original Policy Issue	53	73	62
Age at Life Settlement	64	93	76
Policy Size	$250,000	$5,000,000	$2,300,000
Settlement Amounts	$29,000	$3,100,000	$500,000

Source: GWE policy data, 2017-2022

File # 4743844.2 Expires 05/2026

Case Study #1

A 59-year-old client purchased a $1 million guaranteed universal life policy at Super Preferred rates. At age 75, he had developed mild health issues that would have made him a standard or mildly substandard risk for new coverage. The GUL policy had no cash surrender value.

The client first went directly to a settlement company and got an offer of $115,000 for his GUL policy. He then agreed to have Greenberg, Wexler & Eig represent him and send out his policy for auction. One of the buyers initially offered $210,000, However, by leveraging against the other offers, we were able to get the buyer to increase their offer to **$243,000** to win the case.

Case Study #2

A 62-year-old client purchased a 10-year term policy for $3 million of death benefit at Standard Non-smoker rates. This policy had a conversion feature to any permanent policy offered by the company for the full 10-year level premium period.

Several years later, he experienced a significant change in health and was no longer insurable. He was able to sell his in-force policy for a **$1.3 million,** provided that the term policy was converted to universal life prior to settlement. He used the proceeds to help with his medical expenses and supplement his retirement income.

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PROS AND CONS OF LIFE SETTLEMENTS

As with any major financial decision, policy owners should weigh the advantages and disadvantages of selling their policy and consider alternatives.

Some of the advantages of a life settlement are:

- Selling a policy offers expanded choices and potentially greater value than that offered by surrendering or lapsing a policy
- Policy owners might not be able to afford continued premiums, and would thereby risk having the policy lapse without value
- Even term policies may be eligible for settlement
- Settlement proceeds in excess of the cash value are now taxed at favorable capital gains rates

Some of the disadvantages of a life settlement are:

- Holding and sufficiently funding the in-force policy until death might give a better overall economic outcome
- Death benefits are usually income tax free, while a life settlement is considered taxable income
- Proceeds of a life settlement are available to creditors, whereas debts cannot be collected from the death benefits paid to beneficiaries

Before jumping into a full life settlement, policy owners should consider all their options. If leaving money to heirs is of paramount importance, then reducing the face amount and/or increasing the premiums can help assure payment of the death benefit. In some situations, the owner might still want an income tax-free death benefit for their families but doesn't want the premium expense. In this case, a possible option is for the owner to ***retain*** part of the death benefit along, along with a cash settlement for the remaining portion of the death benefit. The buyer then pays the ongoing premiums for the entire policy.

We are happy to work with advisors and your clients to weigh all the options and determine if a life settlement is right for a given situation.

File # 4743844.2 Expires 05/2026

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Mike is the Director of Case Design and Client Services at Greenberg, Wexler & Eig, LLC. Mike applies his extensive knowledge of life insurance to deliver clear and understandable presentations to assist clients as they make decisions regarding the structure and funding of new life insurance or optimizing the performance of their existing life insurance portfolios. Mike is a Fellow of the Society of Actuaries (FSA) and a Certified Financial Planner (CFP®)

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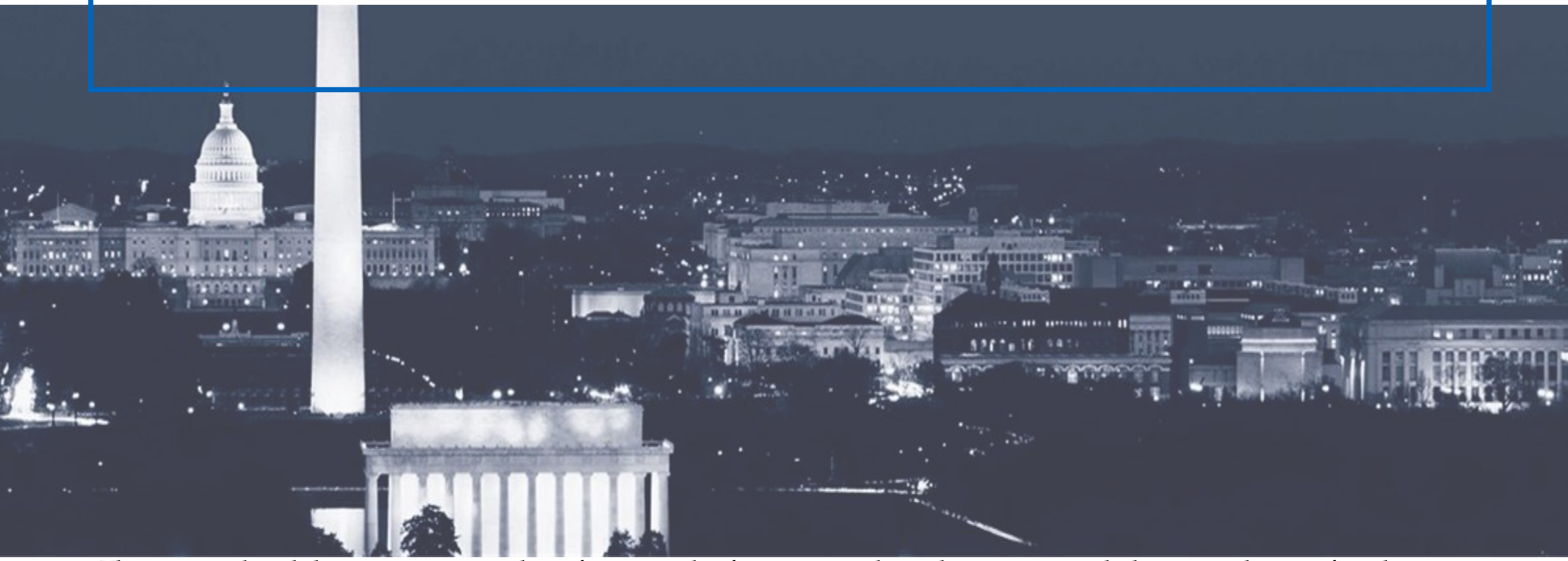
David is a recognized technical authority on insurance planning for personal financial security, business succession plans, qualified and non-qualified retirement plans, estate and divorce planning. David has a BS in psychology from the University of Denver. He received his CLU and ChFC designations from The American College, has certificated in Personal Insurance Planning and Business Insurance Planning from the Life Underwriters Training Council and received the Accredited Estate Planner (AEP) ® from the National Association of Estate Planning Councils.



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