



Transaction-Related Questions

WHAT IS A LIFE SETTLEMENT TRANSACTION?

A life settlement transaction involves the sale of the ownership of an in-force life insurance policy issued by an American life insurance company (carrier) to a third-party investor. The sale is typically for cash consideration that is less than the face value of the policy, but more than the surrender value offered by the issuing carrier. The new owner adopts ongoing responsibility to pay premiums to the issuing carrier and claims the policy's death benefit when the policy matures. The market is specific to the USA due to the country's legal and regulatory framework, under which life insurance policies are considered property, the legal ownership of which can be transferred by sale.

WHAT ARE THE BENEFITS TO THE POLICYOWNER FROM SELLING THEIR POLICY IN THE LIFE SETTLEMENT MARKET?

The main benefit to policyowners - consumers - is that the life settlement market provides them with the opportunity to sell their life insurance policy for a higher price than they would receive from the carrier based on the surrender value of the policy. Selling a life insurance policy releases cash to the insured from what is otherwise an illiquid asset, which they can use at their discretion.

WHY DO POLICYOWNERS SELL THEIR LIFE INSURANCE POLICY?

Numerous reasons exist as to why policyowners might seek to sell their life insurance. They may no longer require the policy if the original purpose of the policy no longer exists; for example, providing for their spouse and / or children if they die. Policyowners may need cash liquidity owing to their current financial situation; they may need cash to fund health-related expenses; or, simply, the premium costs have become unaffordable.

HOW ARE LIFE SETTLEMENTS VALUED?

There is no standard methodology for valuing life settlements. They are relatively illiquid, compared to the likes of public equities and bonds, and therefore policies are typically valued on some sort of mark-to-model basis. A probabilistic element is usually considered, and pricing is adjusted based on prevailing market trends. The biggest driver of value is the life expectancy of the underlying insured, as this determines the projected amount of premiums payable before the death benefit is received.

WHAT IS A LIFE EXPECTANCY AND WHAT IS ITS IMPACT ON THE LIFE SETTLEMENT MARKET?

Life expectancy (LE) is a statistical term used to describe the average future duration for which an individual is estimated to survive; some insureds will die earlier, and others will die later, than the average. There are several well-established and recognised medical underwriters in the life settlement industry who have developed their own mortality tables specifically for the life settlement population.

These LE providers typically review medical records of the insured and apply debits or credits to the mortality table to derive an average (typically a mean and median) LE estimate (quoted in months) highlighting all major impairments to the individual's health. Many, but not necessarily all, life settlement investors use LEs to calculate a value for the policy, which then forms the basis of what the life settlement investor is willing to pay for the policy.

IS A LIFE SETTLEMENT TRANSACTION REGULATED?

The life settlement's secondary market in the United States is highly regulated. 45 states of the US, and Washington, DC, maintain a regulated life settlement secondary market and require a licensed 'provider' to be involved in the transaction. Generally speaking, each state that regulates the industry uses one of two Model Acts (or a combination of the two) developed by the National Council of Insurance Legislators (NCOIL), or the National Association of Insurance Commissioners' (NAIC), as the basis of their life settlements secondary market regulatory framework.

DO ANY STATES IN THE USA NOT HAVE A LIFE SETTLEMENT MARKET?

While there are five US states - Alabama, Missouri, South Carolina, South Dakota and Wyoming - that do not have a regulatory framework in place for life settlement secondary market transactions, life settlement transactions can be, and are, conducted in all states in the US and Washington, DC.

WHO OR WHAT ARE THE PARTICIPANTS IN A LIFE SETTLEMENT TRANSACTION?

There are two distinct markets for life settlement transactions – the secondary market and the tertiary market. The participants in transactions in these markets differ.

Secondary Market Transactions Participants

The secondary market for life settlements has historically been heavily intermediated, and the main intermediaries in a secondary market transaction are as follows:

Insurance agent – a life insurance agent is a licensed professional who sells life insurance. They work either for a specific insurance company or they work independently, selling policies issued by one or more insurance companies.

Broker – a life settlement broker is a licensed person or company that is working on behalf of a policyowner and, for a fee or commission, brokers the sale of a life insurance policy from a policyowner to a provider.

Provider - a life settlement provider is the buyer on record in the transaction. These firms are licensed at the state level (in those states that have a regulatory framework) and they buy on behalf of a client, for example, a life settlement investment fund manager, or occasionally, on their own account.

Tertiary Market Transactions Participants

The tertiary market for life settlements is less intermediated. Trades often happen on a bilateral basis, though for larger transactions, they may use an intermediary.

Specialist firms offer services to the types of firms mentioned above in both the secondary and tertiary markets. Lawyers, life expectancy providers, actuarial firms, accounting firms, banks and many more provide essential support to their clients in the life settlement transaction process.

WHAT IS THE PROCESS THAT A LIFE SETTLEMENT TRANSACTION FOLLOWS?

The transaction process in the secondary and tertiary market for life settlements differs.

Secondary Market

The secondary life settlement market has evolved significantly in recent years. Historically, the policy owner would contact their insurance agent, who would then contact a local licensed broker. The broker would evaluate the likelihood that the policy was suitable for sale. If the answer was yes, they would conduct an auction for the policy with life settlement providers; the provider that bids the highest amount would be the successful buyer.

Whilst a large proportion of policies are still sold in this manner, there is now a growing direct to consumer market where policy owners can sell their policies direct to providers, thereby eliminating some of the intermediary fees. With increasing public awareness of the life settlement option as an alternative to surrendering a policy, this segment of the market is expected to continue to grow.

Tertiary Market

In the life settlement tertiary market, the seller of a block of policies does not need an intermediary for regulatory purposes and can contact other investors in the industry directly in order to negotiate for the sale of those policies. Large tertiary market trades can use an intermediary, such as an investment bank or speciality broker, to manage the sales process, however.