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Life Settlements: Securities Fraud Warning

Lately, particularly now that so many elderly investors have an immediate need for cash to pay fixed expenses, financial advisors have begun offering seniors or elderly investors the opportunity to sell their existing life insurance policy for cash. Such a transaction is known as a "life settlement." Although these life settlements may be being offered by brokers at many of the large brokerage firms, like Banc of America, Raymond James, Edward Jones, Wachovia, Wells Fargo, Merrill Lynch, and Morgan Stanley, a life settlement is still not without its risks. These investment "opportunities" have come under scrutiny by the regulators, including FINRA, and are of particular concern in places where there is a large concentration of retired or elderly investors, like Florida, California, and Arizona.

Essentially, a life settlement (or senior settlement) involves selling an existing life insurance policy to a third party, generally an institutional investor or hedge fund, for more than the policy's cash surrender value, but less than the net death benefit.

While life settlements can be a valuable source of liquidity for senior investors who would otherwise surrender their policies or allow them to lapse—or for people whose life insurance needs have changed, they are still not appropriate for everyone. As discussed below, life settlements can have high transaction costs and unintended consequences and investors should be leery that their financial advisor may be offering them this life settlement for the wrong reasons.

The following is some basic information on life settlements. For more information, visit http://www.finra.org/Investors/ProtectYourself/InvestorAlerts/AnnuitiesAndInsurance/p018469

What Is a Life Settlement?

Until recently, if an investor owned a life insurance policy that the investor no longer wanted or needed, there were two choices: surrender the policy for its cash value or allow it to lapse. Now, there is a third option: selling the policy (or the right to receive the death benefit) to an entity other than the insurance company that issued the policy in a transaction known as a life settlement.

This new option is similar to the viatical settlements that developed in the 1980s and which were such a problem for investors. Unlike viaticals, which generally involved policyholders that were terminally ill (such as AIDS patients), life settlements typically involve policyholders who have a life expectancy of between two and ten years. Life settlements also tend to involve policies with higher net death benefits than viaticals, making them potentially an even bigger business and possible problem down the road. The life settlement market has expanded rapidly in recent years and although still in its infancy may already be a $100 billion industry.

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How Do Life Settlements Work?

The purchasers of life settlements generally are institutions that either hold the policies to maturity and collect the net death benefits or resell policies—or sell interests in multiple, bundled policies—to hedge funds or other investors. In exchange, the investor receives a lump sum payment from the purchaser. The amount the investor will receive from a prospective purchaser depends on many factors, including the investor's age, health and the terms and conditions of the policy—but it is generally more than the policy's cash surrender value (otherwise the investor would be better of just accepting the cash surrender value from the insurance company) and less than the net death benefit.

When an investor sells its life insurance policy, the purchaser is basically acquiring a financial interest in the insurance holder's death. After paying the investor a lump sum for the policy, the buyer assumes the contractual rights and obligations of the policy, including agreeing to pay any additional premiums that might be required to support the cost of the policy for as long as the investor lives. In exchange, the buyer will receive the death benefit when the holder dies.

Factors to Consider When Deciding to Sell Your Life Insurance Policy

Such life settlements have proven profitable not only for institutional investors that purchase these policies, but also for the providers and brokers who handle these transactions. As such, the likelihood that investors, particularly elderly investors, will be offered such a life settlement is likely to only increase. Also, since the life settlement industry is relatively new and may target seniors who may be in poor health, it can be prone to aggressive sales tactics and abuse.

Under what circumstances would a life settlement make sense?

A life settlement might make sense for an investor if the investor no longer wants or needs the current policy—or if the insurance holder can no longer afford the expense of paying insurance premiums and is willing to give up or replace the coverage. Even then, however, investors should proceed with caution. This is a profitable product for the industry and whenever the commissions are high, the prospect of abuse by the financial advisor brokering the transaction naturally increases.

Significantly, if the investor's sole objection is a need for cash, there are other less expensive options that accomplish the same goal. For example, the investor might be able to borrow against the policy or accelerate the death benefits. If the financial advisor does not at least mention these options, the financial advisor's motivation in offering the life settlement may not be the client's interests but his/her own.

What are the transaction costs?

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Life settlements can have high transaction costs. The commissions paid by life settlement companies to life settlement brokers and other financial professionals involved in the transaction can be as high as 30%. As such, any investor considering a life settlement should ask their financial advisor what they are being compensated for their role in the transaction, and what other parties are receiving commissions.

If you have questions about a life settlement you sold, or if you believe that you have been the victim of a securities fraud, the Law Offices of David A. Carter, P.A. can help. The Law Offices of David A. Carter, P.A. is a South Florida securities fraud, securities arbitration, investor protection, and Chapter 7 bankruptcy law firm based in Boca Raton. David Carter is a securities attorney that reviews securities fraud cases throughout the country and Florida, including securities cases in Delray Beach, Boynton Beach, Stuart, Fort Myers, Naples, Deerfield Beach, Fort Lauderdale, and Fort Pierce. To contact the Law Offices of David A. Carter, P.A., please call 561-750-6999, or email us at contact@carterpa.com.