LIFE SETTLEMENTS: WHY CLIENTS DON'T HAVE TO DIE OR BE TERMINALLY ILL TO GET VALUE FROM THEIR LIFE INSURANCE

The University of Texas School of Law

25th Annual Estate Planning, Guardianship and Elder Law Conference

August 11, 2023
Galveston, Texas

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A. Introduction. In developing an estate plan for clients, insurance can often play a key role. This paper seeks to review (i) why clients purchase life insurance, (ii) the types of life insurance that are available and which are most often utilized in an estate plan, (iii) the reasons why life insurance, once the contract matures, may no longer be advisable or desired—including the identification of the "crossover point" when continued financial investment in the contract may not yield an optimal result[1], and (iv) strategies for exiting a life insurance contract if insurance will not be maintained, for any reason, including engaging in a life settlement transaction.

Arising from a somewhat sordid history, the life settlement market has developed to be a multi-billion dollar sophisticated institutional investment space that, similar to Sotheby's and Christie's auction houses, requires individuals who are willing to sell their valuable property—in this case existing life insurance contracts. Once a life insurance contract is purchased, there are only four possible outcomes—(1) a death benefit is paid, (2) the contract is surrendered for the cash surrender value, (3) the policy lapses, or (4) the policy is sold in a life settlement transaction. However, it is the fourth option that most advisors to clients, along with the clients themselves, are totally unfamiliar with. In fact, until June of 2017, this author personally had no idea that a life insurance policy could be sold. So, unlike investment funds that invest in portfolios of marketable securities or purchase closely held business interests, life settlement investment funds have a non-traditional investment strategy and seek to purchase an asset that most owners of the asset do not realize is marketable.

[1] *See* Pauloski, Thomas J. and Andrew T. Bishop, "Triangulation: Integrating Life Insurance into the Estate and Investment Plans", Bernstein Private Wealth Management (2019).

The ability to sell life insurance in a purchase and sale transaction is not a new idea, and the authority for a policyowner to sell life insurance was initially confirmed by the United States Supreme Court in *Grigsby v. Russell* 110 years ago. *Grigsby v. Russell*, 32. S.Ct. 58 (1911) (holding that the owner of a life insurance policy can assign the policy to a person having no insurable interest in exchange for money and the agreement to pay the premiums due). Today, the insurance laws of 43 states regulate the sale of life insurance to protect the interests of the parties to a life settlement transaction[2], and the insurance laws in Texas further clarify that an insured, owner or annuitant is authorized to assign, "in accordance with the terms of the policy or contract:

(1) any benefits to be provided under an insurance policy or annuity contract…; or

(2) any other rights under the policy or contract." Tex. Ins. Code § 1108.101.[3]

B. Why Do Clients Purchase Life Insurance? In my estate planning practice, I regularly work with clients who have existing insurance and also advise clients regarding purchasing additional insurance or replace existing coverage in connection with establishing their estate plan. At the time the decision to purchase additional insurance is made, the decision usually is a well-reasoned financial decision that requires coordination among the professional advisors to the client. These advisors include me, as the estate planning attorney, and one or more of the client's financial advisor, insurance advisor (if the financial advisor is not licensed to sell insurance), and accountant. However, the experience many individuals have with purchasing life insurance may not be the same. Life insurance is vulnerable to being aggressively sold by advisors who may not

[2] Alabama, Missouri, South Carolina, South Dakota, and Wyoming do not impose any restrictions on the sale of a life insurance policy, while Michigan and New Mexico regulate viatical settlements, but not life settlements. The difference between a viatical settlement and a life settlement relates to the health of the insured. A viatical settlement generally is available only when the life expectancy of the insured is 24 months or less. I.R.C. § 101(g); *see* Exhibit A and https://www.lisa.org/regulations-overview/.
[3] Other states specifically authorize the sale of life insurance, including Delaware pursuant to the Delaware Viatical Settlements Act, *see* 72 Del. Laws c. 132.

Title search: Life Settlements: Why Clients Don't Have to Die or Be Terminally Ill to Get Value from Their Life Insurance

First appeared as part of the conference materials for the
25th Annual Estate Planning, Guardianship and Elder Law Conference session
"Life Settlements: Why Clients Don't Have to Die or Be Terminally Ill to Get Value from Their Life Insurance"