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Life Settlements—The Hidden Tool to Unlock, Preserve and Rescue Value in the Estate Plan

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Tama's legal tax practice focuses on both the domestic and international aspects of estate planning and family wealth transfer and tax-exempt organizations. Tama began her legal career with Vinson & Elkins in the Probate, Trusts & Estates Group of the Tax Section. After ten years at Vinson & Elkins, Tama continued her legal practice with Klosek Howes LLP and formed Klosek & Associates PLLC in June 2013. Tama has developed extensive experience in income, nonprofit (including private foundations), estate, gift, trust and generation-skipping transfer taxation and marital property planning. Tama has used life insurance extensively in her practice which focuses on advising high net worth and ultra-high net worth clients. Tama is a graduate of Harvard Law School and earned her undergraduate degree in Economics with honors from Columbia University. Tama is Board Certified in Estate Planning and Probate Law by the Texas Board of Legal Specialization and has been widely recognized in Houston and in the State of Texas by her peers and her clients as an outstanding attorney in her field. Tama has received a Chambers Ranking for High Net Worth—Private Wealth Law in Texas. Tama has many local and regional professional affiliations and has presented seminars on a range of topics related to her area of expertise to numerous groups in Houston, Texas and nationally. Tama joined Treyled Life Settlements LLC in March 2021 as a Managing Partner while continuing her trust and estates practice.

Discussion Outline

The Life Cycle of Life Insurance

- Wealthy Clients Have Life Insurance—Why?
- Wealthy People Live Longer
- When Insurance May No Longer Make Sense in the Estate Plan
- Strategies for Exiting a Life Insurance Contract
- Life Settlements
  - What is the Opportunity
  - What to Look For?
  - Enhanced Cash Surrender Value Case Studies
  - Private Client Case Study
  - How to Approach the Market
  - Life Settlement Process and Timeline
  - Regulation and Tax Treatment of Life Settlements
  - Trust Owned Life Insurance
  - Charitable Life Settlement

Concluding Thoughts

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Wealthy Clients Have Life Insurance—Why?

- 54% of all people in the US have some type of life insurance coverage (LIMRA 2020 Insurance Barometer Study)
  - Wealthy people are as likely to purchase insurance in all categories—HNW, UHNW and mass affluent
- Income Replacement and Additional Liquidity
- Legacy
  - Providing death benefit for one or more specific beneficiaries
- Asset Protection
  - Benefits vary by state
  - Texas offers protection for insured and beneficiary for entire cash value and death benefit (Tex. Ins. Code § 1108.051)

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Wealthy Clients Have Life Insurance—Why?

- Liquidity
  - Estate, Gift and GST Taxes
    - Gift, estate and GST tax exemption is $12,060,000 million (2022) and legislation proposed to reduce this amount
      - Early forecasts estimate adjustment for 2023 will increase exemption by $860,000 ($12.92M)
      - The maximum tax rate is 40% and legislation proposed to increase rate
  - Income taxes
    - Gifts (under current law) receive carryover basis (IRC § 1014) and some clients have large IRD assets
  - Other Liquidity Needs
    - Key man insurance/fund buyout at death of key employee
- Retirement Planning, Diversification and Tax Efficient Investment

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Wealthy Clients Have Life Insurance—Why?

- Types of Life Insurance Commonly Used in Estate Planning
  - Level Term—premiums paid to provide coverage for a term of years if the insured dies during the contract term; no cash value accumulates and premiums increase significantly at the end of the level term period
  - Permanent Insurance—combines death benefit with an investment element that is designed to appreciate and reduce the net risk in the policy and higher costs of insurance in later years

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Wealthy Clients Have Life Insurance—Why?

- Whole life—requires highest initial premium because the carrier must guarantee pricing and cash value account growth. Often used for tax efficient investment and retirement planning and less for transfer tax planning.
- Universal life—unbundles the cash investment component of the policy from the death benefit; carrier is not obligated to guarantee a premium. Premiums paid may be inadequate to maintain the policy. Frequently used for estate planning.

- Single and joint life policies—insurance can be purchased on a single life or joint lives paying a death benefit at the second death

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Wealthy Clients Have Life Insurance—Why?

- Most large face value insurance policies are trust owned
  - In general, insurance is exempt from income tax, not estate tax (I.R.C. §§101(a)(1) and 2042)
    - Exceptions include the transfer for value rule (I.R.C. §§101(a)(2)) or if life insurance is held in a pension or retirement plan
  - Insurance held in a properly structured trust is not subject to estate tax at the death of the insured or GST tax if exemption allocated
  - Can make a gift of existing life insurance to an ILIT to transfer insurance outside of taxable estate, but clients may wish to sell insurance to grantor trust to avoid I.R.C. § 2035 and transfer-for-value rule under I.R.C. § 101(a)(2)
    - Determining value of policy is difficult and a risk in sale transaction
    - Concerns regarding grantor trusts under recently proposed legislation

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Wealthy Clients Have Life Insurance—Why?

- Insurance can provide significant leverage of gift, estate and GST tax exemptions
  - Hedge against an early death prior to maturation of other transfer tax techniques
  - Insurance performs REALLY well if insured dies early—however, wealthy people live longer and many universal life policies were originally illustrated and underfunded to last only to age 85 or 90
- IRRs may look reasonable compared with taxable investments and may seem similar between types of insurance contracts, but whether contract performs is a function of the terms of policy

Wealthy People Live Longer

- Average life expectancies under the Updated Static Mortality Tables for Defined Benefit Pension Plans for 2021, IRS Notice 2019-67, are around 81 for men and 83 for women:

APPENDIX

Mortality Tables for 2021

Valuation Dates Occurring During 2021 and Distributions Subject to § 417(e)(3) with Annuity Starting Dates During Stability Periods Beginning in 2021

	Male	Male	Male	Female	Female	Female	Unisex
Age	2021 Non-Annuitant Table	2021 Annuitant Table	2021 Optional Combined Table for Small Plans	2021 Non-Annuitant Table	2021 Annuitant Table	2021 Optional Combined Table for Small Plans	2021 Table for Distributions Subject to § 417(e)(3)
81	0.039501	0.048449	0.048449	0.019500	0.037852	0.037852	0.043151
82	0.043105	0.054292	0.054292	0.022881	0.042662	0.042662	0.048477
83	0.048463	0.060950	0.060950	0.027939	0.048204	0.048204	0.054577
84	0.055612	0.068541	0.068541	0.034693	0.054517	0.054517	0.061529

- Wealthy persons live significantly longer than less wealthy persons—15 years longer for men and 10 years longer for women

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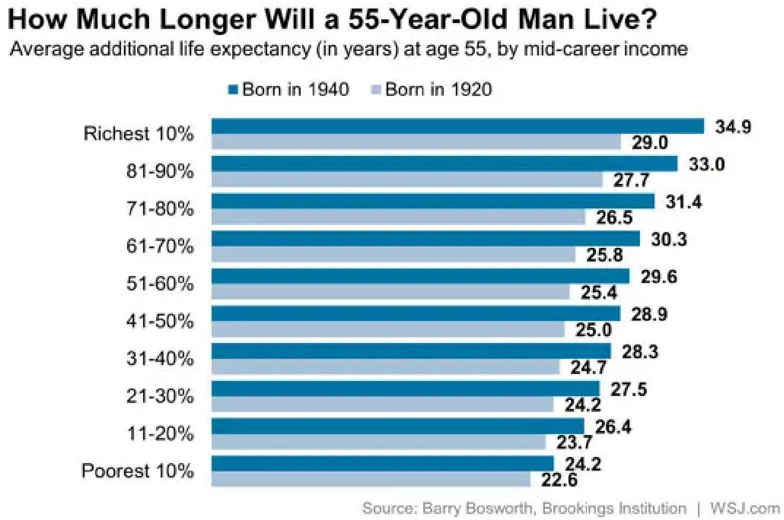
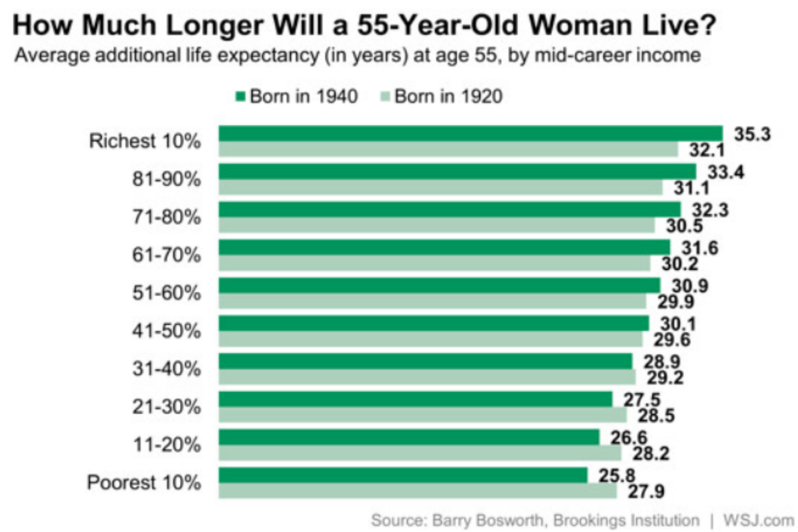
Wealthy People Live Longer

- Wealthy men and women who have lived to 55 are expected to live to be 90
- If wealthy people live longer, life insurance as a hedge against early death unlikely to pay off—50% chance of living over age 90





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When Insurance May No Longer Make Sense in the Estate Plan

- Most term and permanent life insurance policies actually terminate or lapse before they *ever* pay a death benefit (Olin Wharton Business Schools Study 2016)
  - 88% of all universal life insurance contracts are either surrendered or lapse before ever paying a death benefit
  - Virtually all life insurance policies are front loaded, policyholders pay more than the actuarial cost of mortality risk early in exchange for paying less than their actuarial cost later
  - Insurance companies earn large profits on clients who terminate their policies, since policies are often terminated before mortality increases sufficiently above premiums paid
  - Life insurers profit from lapses and must endogenously adopt front loads to encourage lapses
- An estimated 500,000 insurance policies that may qualify for a life settlement lapse or are surrendered annually(Magna Life Settlements Industry Report 2018); however, in 2020 only 3,241 policies were sold in a life settlement transaction and even fewer sold in 2021

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When Insurance May No Longer Make Sense in the Estate Plan

- Life insurance is not a “buy and hold” or “set it and forget it” estate planning strategy
  - Depending on purpose of insurance, continued needs, type of contract purchased, ongoing costs of maintaining insurance versus other investment options (including other insurance) and the value within contract, decision of whether to continue, surrender, lapse or sell the contract may arise
  - UL insurance carriers have demonstrated that they can and will increase costs of insurance which can significantly impact policy performance
  - Some policies may lapse unless significant increased premiums are paid
  - Insured may be funding his or her own death benefit and just trading funds with carrier
  - Policyowner should examine the range of returns from the universe of other investments available and actually unpack the policy illustrations to arrive at realistic returns from continued investment through updated life expectancy

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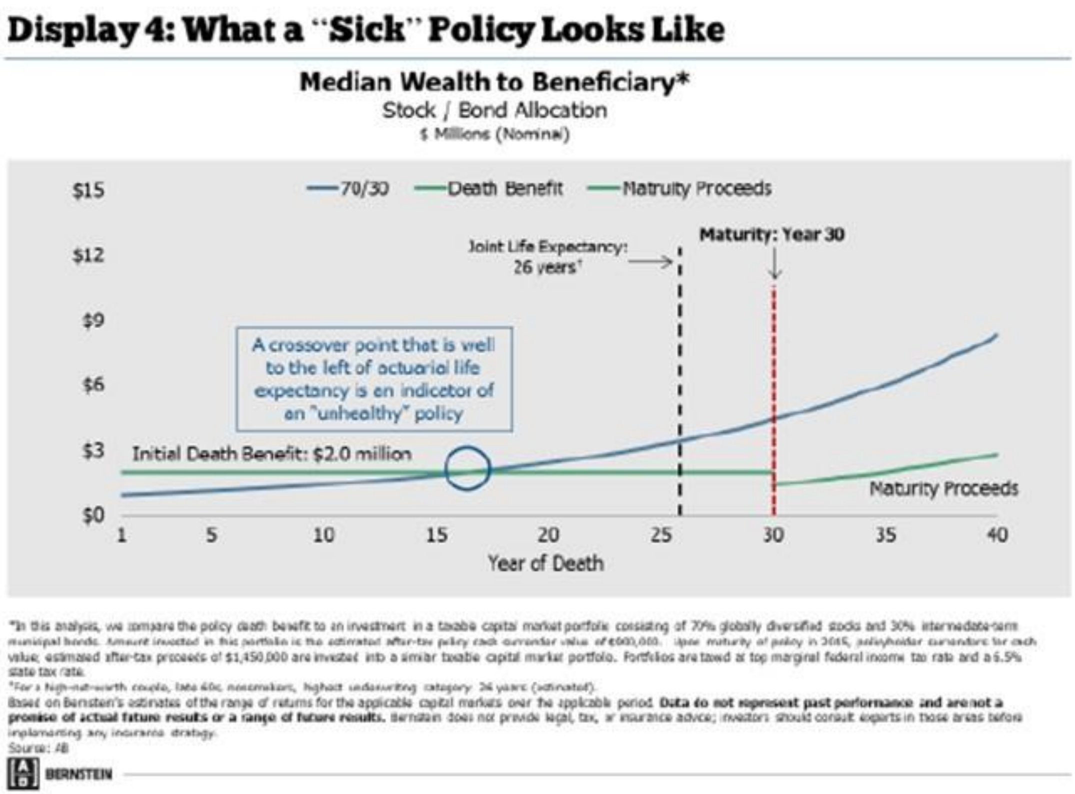
When Insurance May No Longer Make Sense in the Estate Plan

- Sick vs. healthy policy analysis identifies a crossover point and requires coordination among professional advisors



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Strategies for Exiting a Life Insurance Contract

- Most advisors, insureds and policyholders do not know that life insurance is property that can be sold (*Grigsby v. Russell*, 222 U.S. 149 (1911))
- Historically, the owner of a life insurance policy that was no longer needed, desired or advisable had two options: (1) to let the policy lapse or (2) surrender it to the insurer for its cash surrender value
- The secondary market for existing life insurance policies provides a third alternative that most advisors and clients are unaware of: (3) to sell the policy to a third party for less than the expected death benefit but more than the cash surrender value
- The value of a particular life settlement depends on various factors, including the insured's life expectancy and the nature and terms of the policy
- During 2018, 92% of all life insurance policies (by face amount) that terminated were lapsed or surrendered without paying a death benefit (American Council of Life Insurers Fact Book (2019))

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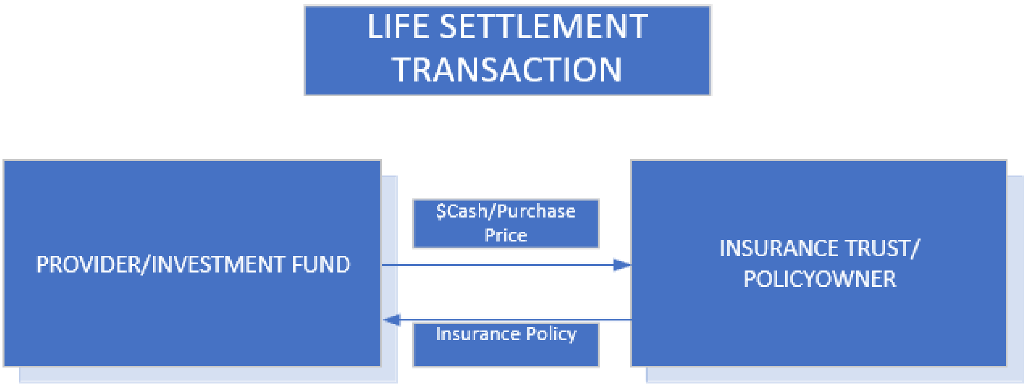
What are Life Settlements?



- At the close of a life settlement transaction, the investor owns the policy and all rights to the death benefit and pays all future premium payments
  - Life settlement provider is regulated by the state where the policyowner resides/trust was established and is the purchaser on behalf of the investor; acts as an intermediary
  - Provider represents only the purchaser, not the seller in the transaction and does not need to offer fair market value
- Policyowner receives a lump sum cash payment that can be used for any purpose—including investment in other assets that may yield a higher return than continued investment in the insurance contract

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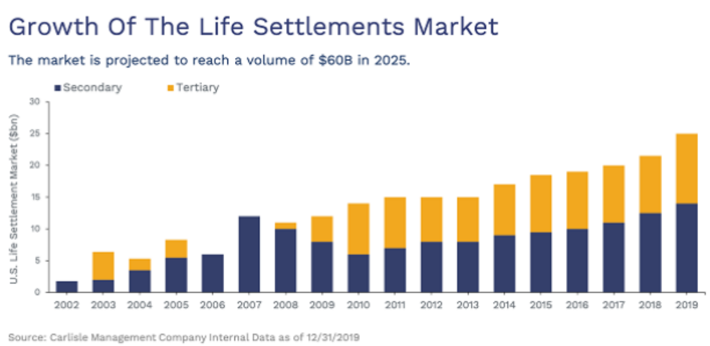
What is the Opportunity?

- The life settlement market has evolved and is a vibrant market backed by multi-billion dollar investment funds and these funds require policies to generate returns
  - Large investment funds are backed by Apollo, KKR, Blackstone, TPG, Vida Capital, Stone Point, Berkshire Hathaway, McKinsey & Co., Corry Capital
    - These funds offer to purchase contracts through a regulated life settlement provider
  - Market is projected to reach a volume of $60B by 2025



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What is the Opportunity?

- Life settlements are as seller friendly as they have ever been:
  - Tax law changes clarified that a seller's cost basis in a life insurance policy is the aggregate premiums paid without reduction for costs of insurance (I.R.C. §1016(a)(1)(B); *see also* Rev. Rul. 2020-5 (modifying Rev. Rul. 2009-13))
  - Some clients no longer require insurance with increase in estate tax exemption and success of other wealth transfer strategies
  - Increased competition in the settlement marketplace increases value to sellers
  - Regulations in 43 of the 50 United States
  - Prolonged low interest rate environment allows investors to pay more for policies but rates are rising
  - London Business School (2013) study concluded life settlements pay more than 4 times on average than the cash surrender value
  - 2021 LISA data showed multiples of cash surrender value paid in a life settlement trended slightly higher for 2021

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What is the Opportunity?

- For some policies, including term, a life settlement can transform a policy (including convertible term insurance) with little or no cash into a sizable amount
- Conning study (2018) determined that $200 billion worth of life insurance is allowed to surrender or lapse annually which results in an estimated $37.5 billion in lost wealth
- Universally acknowledged explanation for lapses—insureds and advisors do not know about the life settlement market
- The differential between surrender value of policy and present value of the policy in a life settlement transaction creates an arbitrage opportunity
- Insurance companies could eliminate settlement market by repricing surrender values to actuarily fair amounts but fail to do so

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What to Look for?

- Clients who indicate they (i) no longer want or need life insurance, (ii) plan to lapse or surrender a contract (even term) or (iii) clients who receive letters from insurance carriers offering to purchase their policies
- In order to identify opportunity to provide resources to clients around life insurance, advisor should discuss life insurance with the client (see Sample Life Insurance Discussion Summary for Advisors)

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Enhanced Cash Surrender Value Case Studies

- Some insurers (Lincoln, John Hancock, Sun Life) have been approaching policyowners with enhanced cash surrender offers to purchase their contracts for more than the cash surrender value but the amount offered bears no relationship to the actual fair market value
  - Lincoln National recently fined by state regulators for making these offers and others are being investigated
- Client with two GUL contracts communicated an offer to purchase for an "enhanced" cash surrender value to financial advisor who introduced client to settlement broker
  - $1 Million Single Life Policy (age 74): offer price from carrier was $48,000; sold for $240,000
  - $1 Million Joint Life Policy (ages 74 and 78): offer price from carrier was $48,000; sold for $135,000
  - Result from sale—client received $375,000 instead of $96,000

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Enhanced Cash Surrender Value Case Studies

- Offer to purchase for “enhanced” cash surrender value brought by financial advisor to settlement broker
  - $10 Million Single Life Policy (age 64; $11 Million with increasing death benefit): offer price from carrier was $908,000; Purchase price was $2,315,000
- Insurance companies are proactively approaching clients to sell policies and advisors can assist clients with a better outcome
  - In each case the client had already made the decision to sell to the insurance company at a lower price
  - Advisor brought significant value by introducing the life settlement strategy

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Private Client Case Study

- Client had an underfunded universal life policy held in trust that was not guaranteed to provide coverage past age 85 without significant premium increases
- Client indicated desire to discontinue making gifts, and cash value was going to be consumed in the near term to cover increased costs of insurance; there was also carrier risk with Voya which exited the insurance space
- The amount required to guarantee the insurance to age 100 was $224,000, and the client had been paying annual premiums of $75,000
- May 2021 Voya Policy Summary:

Total Face Amount: $10,000,000
Death Benefit Option: Level
Premium Class: Class 1 (Preferred Nonsmoker)
Annual Premium: $75,000.00
Total Premiums Paid: $1,705,000.00
Accumulated Value: $1,201,398.14
Cash Surrender Value: $1,201,398.14

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Private Client Case Study

- February 2020 Voya Illustration

			GUARANTEED 4.50% Interest Rate Maximum Charges			NON-GUARANTEED ILLUSTRATED 4.50% Interest Rate Current Charges		
Yr	End of Yr Age	Premium Outlay	Accumulated Value	Cash Surrender Value	Net Death Benefit	Accumulated Value	Cash Surrender Value	Net Death Benefit
21	76	0.00	1,032,019	1,032,019	10,000,000	1,149,810	1,149,810	10,000,000
22	77	75,000.00	746,084	746,084	10,000,000	1,200,823	1,200,823	10,000,000
23	78	75,000.00	384,287	384,287	10,000,000	1,246,156	1,246,156	10,000,000
24	79	75,000.00	0	0	10,000,000	1,284,468	1,284,468	10,000,000
25	80	75,000.00	0	0	10,000,000	1,314,345	1,314,345	10,000,000
		300,000.00						
26	81	75,000.00	0	0	10,000,000	1,334,287	1,334,287	10,000,000
27	82	75,000.00	0	0	10,000,000	1,342,687	1,342,687	10,000,000
28	83	75,000.00	0	0	10,000,000	1,337,810	1,337,810	10,000,000
29	84	75,000.00	0	0	10,000,000	1,318,908	1,318,908	10,000,000
30	85	75,000.00	0	0	10,000,000	1,282,824	1,282,824	10,000,000
		675,000.00						
* 31	86	75,000.00	0	0	0	1,227,259	1,227,259	10,000,000
32	87	75,000.00	0	0	0	1,149,639	1,149,639	10,000,000
33	88	75,000.00	0	0	0	1,047,068	1,047,068	10,000,000
34	89	75,000.00	0	0	0	916,253	916,253	10,000,000
35	90	75,000.00	0	0	0	753,435	753,435	10,000,000
		1,050,000.00						
36	91	75,000.00	0	0	0	643,518	643,518	10,000,000
37	92	75,000.00	0	0	0	507,897	507,897	10,000,000
38	93	75,000.00	0	0	0	344,354	344,354	10,000,000
39	94	75,000.00	0	0	0	147,759	147,759	10,000,000
* 40	95	75,000.00	0	0	0	0	0	0
		1,425,000.00						

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Private Client Case Study

- May 2021 Voya Illustration

				GUARANTEED *4.50% Interest Rate* *Maximum Charges*		
	Yr	End of Yr Age	Premium Outlay	Accumulated Value	Cash Surrender Value	Net Death Benefit
	22	77	0.00	1,148,389	1,148,389	10,000,000
	23	78	75,000.00	823,299	823,299	10,000,000
	24	79	75,000.00	412,662	412,662	10,000,000
	25	80	75,000.00	0	0	10,000,000
			225,000.00			
	26	81	75,000.00	0	0	10,000,000
	27	82	75,000.00	0	0	10,000,000
	28	83	75,000.00	0	0	10,000,000
	29	84	75,000.00	0	0	10,000,000
	30	85	75,000.00	0	0	10,000,000
			600,000.00			
*	31	86	75,000.00	0	0	0
			675,000.00			

* Year 31, Month 1 (August 2029)
In the event that the guaranteed costs were deducted and the guaranteed interest rate was paid from 5/19/2021 forward, the policy would lapse and cannot be quoted beyond the year shown. Additional premiums would be required to continue the coverage.

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Private Client Case Study

- May 2021 Voya Illustration

			GUARANTEED *4.50% Interest Rate* *Maximum Charges*		
Yr	End of Yr Age	Premium Outlay	Accumulated Value	Cash Surrender Value	Net Death Benefit
22	77	0.00	1,148,389	1,148,389	10,000,000
23	78	223,889.00	969,526	969,526	10,000,000
24	79	223,889.00	720,217	720,217	10,000,000
25	80	223,889.00	385,929	385,929	10,000,000
		671,667.00			
26	81	223,889.00	0	0	10,000,000
27	82	223,889.00	0	0	10,000,000
28	83	223,889.00	0	0	10,000,000
29	84	223,889.00	0	0	10,000,000
30	85	223,889.00	0	0	10,000,000
		1,791,112.00			
31	86	223,889.00	0	0	10,000,000
32	87	223,889.00	0	0	10,000,000
33	88	223,889.00	0	0	10,000,000
34	89	223,889.00	0	0	10,000,000
35	90	223,889.00	0	0	10,000,000
		2,910,557.00			
36	91	223,889.00	0	0	10,000,000
37	92	223,889.00	0	0	10,000,000
38	93	223,889.00	0	0	10,000,000
39	94	223,889.00	0	0	10,000,000
40	95	223,889.00	0	0	10,000,000
		4,030,002.00			
41	96	223,889.00	0	0	10,000,000
42	97	223,889.00	0	0	10,000,000
43	98	223,889.00	0	0	10,000,000
44	99	223,889.00	0	0	10,000,000
45	100	223,889.00	0	0	10,000,000
		5,149,447.00			

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Private Client Case Study

- In 2021 Voya would no longer illustrate the non-guaranteed contract that was illustrated in 2020
- Average life expectancy from multiple reports indicated a 14.8 year life expectancy (50% chance that client would live longer than 14.8 years)—well beyond the potential for lapse
  - 76% chance that client will live beyond age 85
- Pre-pricing analysis indicated the policy value would be in excess of the total premiums paid ($1.7M) and may be significantly higher
  - Trustee confirmed willingness to approve a sale for an amount net of fees equal or greater than total premiums paid
  - Net amount received by trust was almost $1M greater than total premiums paid and $1.5M greater than cash surrender value

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Private Client Case Study

- Actual Life Settlements Auction Results

	Provider 1	Provider 2	Provider 3	Provider 4	Provider 5	Bid IRR	Bid Increase
Bid 1	**$1,512,000**					15.24%	
Bid 2		**$2,200,000**				11.17%	$ 688,000
Bid 3				**$2,300,000**		10.73%	$ 100,000
Bid 4	**$2,400,000**					10.31%	$ 100,000
Bid 5					**$2,600,000**	9.53%	$ 200,000
Bid 6			**$2,625,000**			9.44%	$ 25,000
Bid 7		**$2,700,000**				9.18%	$ 75,000
Bid 8	**$2,725,000**					9.09%	$ 25,000
Bid 9			**$2,750,000**			9.00%	$ 25,000
Bid 10	**$2,775,000**					8.92%	$ 25,000
Bid 11		**$2,850,000**				8.67%	$ 75,000
Bid 12			**$2,875,000**			8.59%	$ 25,000
Bid 13	**$2,885,000**					8.56%	$ 10,000
Bid 14		**$2,913,000**				8.47%	$ 28,000
Bid 15	**$3,015,000**					8.15%	$ 102,000

- Provider 1 was opening bid at $1.5M and the highest bid at $3M—without auction $1.5M offer would have been more than cash surrender and may have been accepted

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How to Approach the Market

- What polices are suitable for a life settlement?
  - Individual and second-to-die universal life, indexed universal life, variable universal life and convertible term life insurance policies typically qualify for life settlements and the insured should be over 70 or under 70 with health impairment or large face value coverage
- Only one broker should be engaged to ensure maximum participation by interested purchasers and avoid polluting the file
  - Commissions on life settlements can be significant and some brokers charge a flat fee based on percentage of death benefit (for example, 8%) and others charge combined fees with agents and others receiving compensation of up to 35% of gross proceeds paid
  - Fees should be negotiated and agreed to in advance in writing
  - Role of life agent should be clear and agreed-upon
  - Confirm whether the broker has any agreements with providers or purchasers that could impact the auction process

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Life Settlement Process and Timeline

Policy Pre-Pricing and Analysis

Current Policy Information	Premium Payment History
In-Force Illustration and Statement	Internal Modeling

Constructing File to Market Policy

Application and Services Agreement	Life Expectancy Reports
Medical Records (No New Exams)	Trust Agreement/Title History

Sending File to Market and Closing

Auction Format	Review of Closing Documents
Expedite Closing with Carriers	Funding

If properly conducted and depending on availability of medical information, transactions can proceed efficiently and close within 60 days

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Regulation and Income Tax Treatment of Life Settlements

- Life settlements are authorized transactions nationwide and are regulated for consumer protection in almost every state within the United States
- To the extent the amount received in a life settlement (non-viatical) is in excess of the aggregate premiums paid less amounts received, the policy seller will have taxable gain
  - Grantor pays tax if trust owner is a grantor trust
- The gain will be long term capital gain income unless the cash surrender value is in excess of the premiums paid less amounts received, in which case only that difference would be ordinary income (I.R.C. §1016(a)(1)(B); Rev. Rul. 2009-13 (as modified by Rev. Rul. 2020-5))
  - Capital loss treatment may also be available
  - Situation 3 of Rev. Rul. 2009-13, as modified by Rev. Rul. 2020-5, concluded that the $25,000 loss on the sale of the policy is treated as a long term capital loss which is only deductible if incurred under I.R.C. § 165(c)(1) or (2)

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Regulation and Income Tax Treatment of Life Settlements

- The following illustrates the income tax treatment of settlement proceeds—grantor trust structure provides additional $1.2M to trust:

Income Tax Case Study		
Jerry Age 80		
Death Benefit	$	15,000,000
Direct Purchase Initial Offer (Pre-Tax/Comission Inclusive)	$	1,850,000
Net Amount to Policyowner from Auction Before Taxes	$	5,580,100
Premiums Paid/Basis In Policy	$	612,000
Cash Surrender Value	$	546,000
Gain on Sale	$	4,968,100
Capital Gains Tax Due (23.8%)	$	1,182,408
Net Amount to Policyowner After Commission and Taxes	$	4,397,692
Direct Purchase Offer (After-Tax/Commission Inclusive)	$	1,555,356
Difference Auction and Direct Purchase (After-Tax and Commission)	$	2,842,336

- Also illustrates advantage to full auction over direct purchase and surrender—$4.4M net to client vs $1.55M direct and $546,000 cash surrender value

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Regulation and Income Tax Treatment of Life Settlements

- Sale of insurance policy on terminally ill insured ("viatical") is not taxable (I.R.C. § 101(g))
- An insured is terminally ill if physician has certified death within 24 months of the date of certification
- A viatical settlement provider defined in I.R.C. § 101(g)(2)(B) must be the purchaser for proceeds to be excluded from income

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Trust Owned Life Insurance

- Trustees have fiduciary duties to monitor and manage policies held in trust
- Trustees may not be aware that if a donor does not wish to continue to make premium payments there is an option for a settlement to preserve value
  - 90% of all insurance trust fiduciaries have no specialized knowledge or skills to manage insurance
  - Trustees should obtain regular policy statements and in force illustrations and coordinate reviews and/or audits with an insurance professional
  - Trustees should confirm and communicate to donor/grantor and beneficiaries when policies held in trust are projected to lapse

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Trust Owned Life Insurance

- Life settlement is an important option for all trustees, including corporate trustees, to understand and preserve value to trust beneficiaries
  - Proceeds are greater than from surrender (or lapse) and continue to be held for the benefit of desired beneficiaries under trust terms
  - Grantor pays income taxes for policies held in grantor trusts
- Exculpatory clauses may not protect trustee from liability for breach of fiduciary duties (*Rafert v. Meyer*, 209 Neb. 219 (2015))

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Charitable Life Settlement

- Clients with life insurance that is no longer required or desired may wish to benefit charity/DAF currently
  - Charitable gift of life insurance can be combined with a settlement to extract value for current giving
  - May be an option for trust owned insurance as well
- Deduction should equal the fair market value of the policy reduced by any portion that would be ordinary income if the policy were sold (Rev. Rul. 2009-13; Treas. Regs. § 1.170A-4(b)(1))
- Donation must be reported on IRS Form 8283, Noncash Charitable Contributions, and a qualified appraisal obtained (I.R.C. §170(f)(ii)(c))

Charitable Life Settlement

- Gross amount paid in a life settlement transaction should establish fair market value of policy for qualified appraisal
  - Fair market value should be gross purchase price without reduction for costs associated with sale similar to valuation of assets for estate and gift tax purposes that do not reflect costs of sale even though amount received is net (Treas. Reg. § 20.2031-1(b) and § 25.2512-1; *see also Estate of Smith v. Comm'r* (1972))
- Charities already owning insurance can also consider a settlement to accelerate receipt of funds for charitable purposes and avoid additional premium contributions that may not be provided by the insured/donor or advisable

Concluding Thoughts

- Studies have found that
  - *an estimated 88% of all universal life insurance policies issued are surrendered or lapse before paying a death benefit and*
  - *an estimated 500,000 insurance policies that may qualify for a life settlement lapse or are surrendered annually*
  - A staggering amount of premium dollars are wasted
- Estate planning attorneys, wealth advisors, corporate fiduciaries, accountants and insurance advisors can assist clients to recover funds trapped in life insurance that is no longer desired or advisable and avoid continued investment in contracts that do not provide an optimal result
  - Ask clients about their life insurance at the client intake or at your next meeting
  - Insurance should continue to be monitored and managed similar to other investment strategies—regular policy reviews are essential

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Concluding Thoughts

- Become informed regarding life settlements and share this information with clients and others at your firm in advance of policy lapses or surrenders
  - Demonstrates your firm provides full range of solutions for insurance to clients and can lead to additional opportunities with the client and within the firm
  - Consider adding information about life settlements to firm insurance trust memoranda and other materials
  - For attorneys and corporate trustees, consider adding life settlements to insurance trust powers specifically authorizing the sale of insurance held in trust (See Sample Life Insurance Memorandum and Trust Language)
  - If there is a different insurance need, alternative wealth transfer or investment strategy or life settlement opportunity, you may bring a valued solution to a client problem which builds on existing trust in the team providing services and your firm

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Concluding Thoughts

- Exculpatory clauses may not protect from liability for breaches of fiduciary duties such as care and duty to inform
- A life settlement auction process conducted by a single knowledgeable team creates real competition in the market and yields better pricing than a direct sale to a purchaser and more than the cash surrender value
- Not every policy is a candidate for a life settlement

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