CANADIAN LIFE SETTLEMENTS

Life Settlements: A Canadian Perspective

(For Financial Planning Professionals)

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Executive Summary

As trusted advisors, our clients often ask us for counsel regarding financial matters outside of our area of expertise. For example, an accountant may be asked for investment advice by a client who is concerned about their portfolio's performance, or a financial planner may be asked about income tax minimization.

In such situations, an advisor with a base level of knowledge will be more likely to point a client toward a solution. In contrast, an uneducated advisor may hold back their guidance due to lack of confidence with the subject matter. The educated advisor is empowered to take a client centric approach, whereas the uneducated one may miss an opportunity to help their client and strengthen a relationship.

It is not uncommon that the original purpose for a life insurance policy ceases to exist and/or the premium cost to pay for the insurance becomes unaffordable. In these circumstances, decisions about what to do with a policy are frequently mishandled by both clients and advisors. This often occurs due to lack of awareness regarding all the options for dealing with the situation.

The well-known alternatives to maintaining an unneeded or financially burdensome policy are to stop paying the premiums (breaking the contract and letting it expire worthless), or if applicable, surrendering it to the carrier for its Cash Surrender Value (often a small fraction of the full death benefit). These are the options which are fully disclosed by the Canadian insurance carriers.

However, there is much less awareness regarding other liquidity options such as Life Settlements or policy loans. A Life Settlement is the sale of a life insurance policy from the original policy owner to a third-party. The selling policy owner receives an upfront cash payment in exchange for transferring ownership and all beneficial rights of the life insurance policy, and the new third-party owner continues to make the ongoing premium payments.

The benefits of a life settlement transaction can be multifaceted. For those over age 70, or with a life-shortening medical condition, there is the possibility of receiving substantially more than the Cash Surrender Value offered by the insurance carriers, which could provide a client with access to much needed funds, while relieving the burden of monthly premiums.

From an advisor perspective, awareness of all the life insurance liquidity options in Canada could help enhance your relationship with a client through providing them with fiduciary-level solutions and help you obtain new clients through future referrals.

It is incumbent upon advisors to educate themselves regarding life settlements in the same way they would learn about other financial strategies, and the reason is simple: in certain circumstances it could be the best option for dealing with a suboptimal life insurance contract.

This white paper provides information geared toward a broad range of financial professionals regarding the secondary market for life insurance – usually called "Life Settlements". Given that approximately 22 million Canadians own life insurance it should be a professional development focus area for a broad range of specializations. Life settlements and insurance could be discussed with a client for many reasons:

- **Lawyers** – when working with clients on a will, estate, or separation agreement.
- **Bankruptcy Trustees** – During a client consultation on methods for paying down debt.
- **Accountants –** while working with business owners who own policies or while addressing life insurance that may no longer be needed.
- **Financial Planners** – After updating a client's plan and noting a changed protection need.

The Opportunity:

Some estimates put the Canadian life insurance policy lapse rate at 80%, which converts to an annual dollar value of approximately $6.5 billion that will never be paid out to policyholders or their families. [ii]

The 2016 Edition of Canadian Life and Health Insurance Facts published by the Canadian Life and Health Insurance Association of Canada (CLHIA) states that Canadian ownership of Universal and Whole life insurance products was 25% of the entire market from 2005 through 2015 .[iii]

As mentioned, decisions with respect to insurance assets are frequently mishandled by clients and advisors alike due to lack of awareness of the options available. To wit, billions of dollars worth of life insurance coverage are allowed to lapse or are surrendered back to the insurance carriers by financial consumers each year because it is no longer a good fit for their lives. Therefore, many consumers are not realizing the Fair Market Value for their policy.

When an individual buys life insurance, it is unlikely that lapsing the premium payments and voiding the contract is preplanned. This is especially true for those Canadian consumers who purchase universal, whole life, and T100 policies under the pretext that they will provide life long insurance protection. However, the inevitable changes that come with time can make an insurance policy that was bought for specific reasons in the past, impractical to present and future circumstances.

It is not uncommon that the original purpose for which life insurance was purchased ceases to exist altogether:

a) **Changes in the insureds estate plans:** Perhaps a spouse or another beneficiary for whom the policy was purchased is now deceased. Maybe another type of policy would prove adequate to cover the original goals and provide necessary protection.

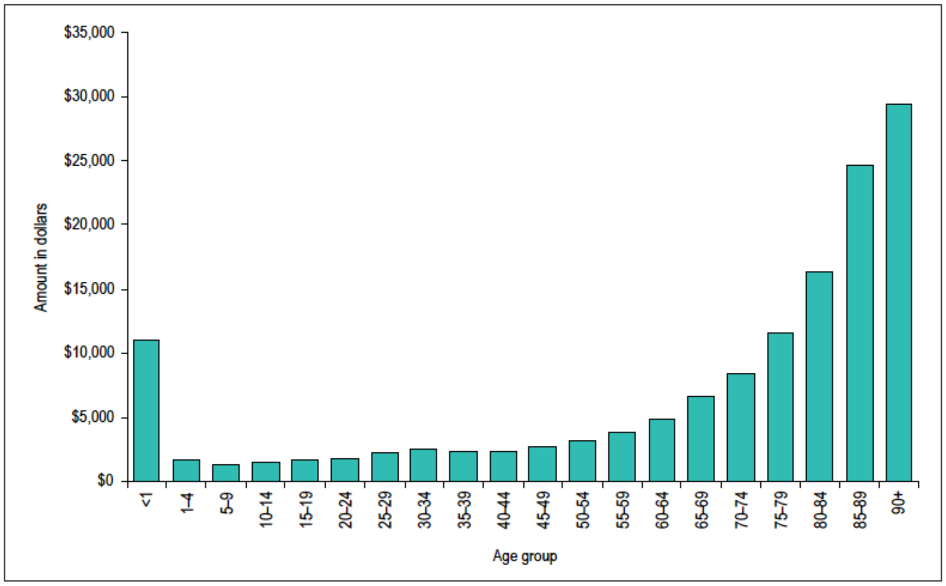
b) **The needs of the beneficiaries may have changed:** An individual may have taken out a life insurance policy 20 years ago when he or she had young children. Now those children have grown up and are financially independent, so their parent's insurance is no longer a necessity.

c) **Required insurance on a business has become redundant:** Life insurance may have been purchased for various reasons to protect the stakeholders of a business. Perhaps it insured the key people in a company, but the organization has now repaid its bank debt, partnerships have dissolved, or the insured individuals have retired.

d) **Escalating policy premiums:** Many people are not prepared for the steep escalation in premiums that accompanies ownership of certain types of policies. When such an increase occurs, an evaluation is often made regarding the need for the insurance vs. the cost.

e) **Rising healthcare costs or mounting financial concerns:** Health problems and other unforeseen difficulties can create circumstances that increase financial burdens and needs. Under such circumstances, a life insurance policy that was previously affordable may become too costly.

f) **Lower retirement income:** Historically low returns on safe investments may have impaired the income of a retiree while the impact of inflation on lifestyle costs has been significant. This may lead to a reconsideration of an under performing universal life policy as a sound financial choice or simply a review of high premium costs in light of low income.



Provincial / territorial government health expenditure per capita, by age group, Canada, 2015

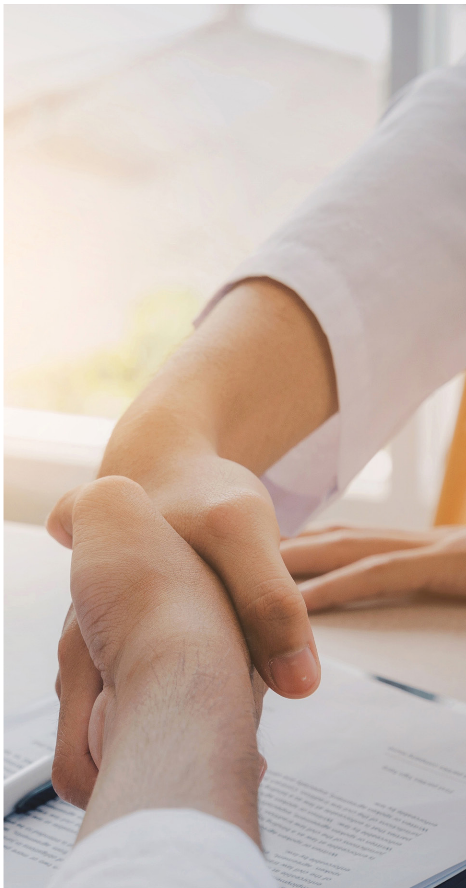
Initial sales illustrations for Universal Life policies may have projected annual returns for the investments in the policy which offset the cost of the increasing premiums over time. However, Insurance policy growth has only rarely performed in line with their original illustrations, so premium offsets are rarely achieved. [iv]

A similarity among these conditions is that they have a higher probability of occurring in older age. The result is that Canadian seniors are the demographic most likely to require a reassessment of their insurance needs and if their existing policy is optimally serving them.

The Solution:

Policyholders who have determined that their life insurance is redundant or impractical to their life situation are offered few options by Canadian insurance providers for dealing with the asset. For those who do not want to keep a policy in force, their first option is to stop paying the premiums (therefore lapsing the policy and letting it expire worthless), or it may be surrendered back to the insurer for its Cash Surrender Value (often a fraction of the full death benefit).

However, there is another option that many consumers and advisors are not aware of called Life Settlements. A Life Settlement is the sale of a life insurance policy from the original policy owner to a third-party. The selling policy owner receives an upfront cash payment or a contracted series of payments, in exchange for transferring ownership and all beneficial rights of the life insurance policy – typically for more than any existing cash value but less than the policy's full death benefit – and the third party as the new owner then continues to make the ongoing premium payments. This removes the prior owner from all financial obligations to the insurance carrier, and when the insured passes away, the new owner collects the policy's death benefit. Depending on the needs of the seller, it can also be arranged that they retain a portion of the policy death benefit.



In many cases, the amount received will be substantially higher than the Cash Surrender Value offered by the life insurance company. In fact, a study of 9,002 policies by the London School of Business found, on average, a Life Settlement transaction **provided a payout of more than four times that of the Cash Surrender Value provided by insurance companies.** [vi] This represents a more equitable economic value to the financial consumer as a return for years of diligently making premium payments.

Determining the market value of an insurance policy in a Life Settlement Transaction

There are four components to determining the value of a life policy:

a) Amount of the death benefit

b) The life expectancy of the insured on the policy

c) The cost of insurance (premiums) which are required to keep the policy in force

d) The discount rate or investor required rate of return

Every case is different. However, when analyzing a life insurance policy, the death benefit is always known, and in most cases, the amount of annual premium payments can be determined within a reasonable probability. The expected remaining life of the insured is the factor with the greatest variability. Predicting how long any one individual will live is uncertain, based on age, gender, health and lifestyle. However, actuarial tables supplemented with current medical information provides guidance to those who offer Life Settlements.

The calculation of the value of a Life Settlement transaction can be explained in a straight forward example. Let's consider an example of an individual who has a life expectancy of 10 years. The individual owns a whole life insurance policy with an annual premium of $5,000 and a death benefit is $125,000. Let's also assume that the life settlement provider is targeting a 10% return for purchasing the policy. The life expectancy of the insured has been estimated to be 10 years. We can create a discounted cash flow analysis to establish the market value of the policy:

Premium	$5,000										
Death Benefit	$125,000										
Discount Rate	10%										
Cash Surrender Value (CSV)	$0.00										
Year	**0**	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Premium Payment		-$5,000	-$5,000	-$5,000	-$5,000	-$5,000	-$5,000	-$5,000	-$5,000	-$5,000	-$5,000
Death Benefit											$125,000
Net Cash Flow		**-$5,000**	**-$5,000**	**-$5,000**	**-$5,000**	**-$5,000**	**-$5,000**	**-$5,000**	**-$5,000**	**-$5,000**	**$120,000**
Discount Factor (1/(1+r)^n)		0.91	0.83	0.75	0.68	0.62	0.56	0.51	0.47	0.42	0.39
Discounted Cash Flow		**-$4,545**	**-$4,132**	**-$3,757**	**-$3,415**	**-$3,105**	**-$2,822**	**-$2,566**	**-$2,333**	**-$2,120**	**$46,265**
Policy Value	**$ 17,470.08**										

Benefits to Consumer:

There is still a broad lack of awareness among Canadians, both individuals and advisors alike, that Life Settlements are an option. **A 2010 survey prepared for the Insurance Studies Institute indicated that 90% of seniors in the U.S. who have let a policy lapse would have considered selling it if they had known a Life Settlement was possible.** In addition, 49% of advisors cited lack of knowledge as the reason for not recommending a Life Settlement option to clients. [vii]

There are many reasons for the lack of awareness, not least of which is a possible reluctance to discuss this type of transaction because it is associated with end of life. However, a client's emotions surrounding a financial decision should not necessarily change the counsel that an advisor gives. On the contrary, guiding clients through their emotions toward rational financial decisions is one of the highest value services that a trusted advisor may provide.

It is debatable whether maintaining an unneeded policy honours the client and / or their family, despite the connection with end of life, and Life Settlements are simply another tool for advisors to use when helping to navigate this type of situation.

Life Settlements can provide consumers with a Fair Market Value for impractical life policies that they no longer require or cannot financially maintain. This may provide individuals with both financial and emotional benefits:

a) **Access to emergency cash:** Sometimes people need to liquidate assets to gain access to cash. In situations where a policy is deemed to be expendable, a Life Settlement can provide an influx of needed funds.

b) **Create additional monthly retirement income:** Life Settlement transactions can be structured to provide the previous owner with a monthly payout on their policy for life. Like an annuity payment the amount will vary with the amount of funds available and the term over which the payment will be made. In many cases it may not be enough to live on independently, but it can help supplement existing retirement income.

It is important to note that not all life insurance policies are good candidates to be sold in the secondary market. Some seniors may still need their life insurance for its original purpose and these policies may still be cost effective and affordable. It can also be argued that, assuming a deterioration in the insureds health, the policy becomes an increasingly valuable estate asset which might be better retained. For very healthy seniors with poorly performing policies or those with policies involving increasingly unaffordable premiums, a Life Settlement may not be available. In such situations, a policy exchange to a more suitable life insurance policy may be the better answer if the current policy is no longer appropriate.

Interesting Fact:

Academic studies demonstrate that when the secondary market for a financial product is robust, it brings overall consumer benefits such as liquidity improvements and lower consumer risk. This increases demand for the product and the price the consumer is willing to pay in the primary market.

Canadian life insurance as an overall product stands for significant improvement through the opening of the secondary market place, where presently, insurance carriers have almost monopolistic power.

Depending on the type of policy, the insurance carriers will either offer the consumer $0.00 or a small Cash Surrender Value.

A strong secondary market for life insurance assets levels the playing field for consumers by providing them with a "fair market bid" for their policies. Furthermore, as experienced in the U.S. market, when the number of Life Settlements Providers grows and competition increases, regulation also enhances and the prices paid to consumers for their policies incrementally improves as well.

c) Fund medical or hospice care: Life Settlements can help fund things like hospice care, medical expenses, and regular expenses or provide income replacement while seeking treatment.

d) Relieve burdens of monthly premiums: After a certain age, life insurance often becomes unaffordable for people living on a fixed income. Not only does a settlement provide cash but it also relieves future premium payments.

e) Relieves the psychological burden of servicing an asset one doesn't need: there is a form of relief in knowing that an asset was dealt with in the best way possible, and letting it expire worthless was avoided.

f) Money can be used to purchase another policy: (perhaps for travel) that makes more sense to a personal situation.

When choosing a Life Settlement provider, there are some important details to keep in mind:

- **Ensure the provider has systems in place to protect sensitive data**: During the completion of a Life Settlement transaction, the provider will need to access some of the clients' personal details, including medical and financial data. It is important to determine that a provider values privacy and has an organizational privacy policy which they adhere to before using them.
- **Seek a provider that gives proper consumer disclosures and balanced views in promotional material:** Providers should inform the consumer about the alternatives to the life settlement option. Furthermore, aggressive sales tactics that appear biased or unbalanced are a red flag.
- **Ensure provider holds life policies in a blind pool with multiple investors:** In a Life Settlement transaction it is important to verify who the final owner of the policy will be. The confidentiality of a client is better protected when their policy is bundled together with hundreds of other policies and held by a fund that maintains information regarding its "policy investments" strictly confidential.
- **Membership with industry associations:** If the provider is a member of industry associations such as The Life Settlement Association ("LISA") - www.lisa.org, they will be obliged to adhere to their Code of Ethics. The business and its employees will likely be more visible on the Internet. Being able to verify the individuals that you are working with is an important part of professional due diligence.

Notes on Canadian Life Settlement Regulatory Regime:

The rights of Canadian policy owners to transact on their life insurance is written into the contractual paperwork of the insurance itself. Policyholders have the right to change/ transfer policy ownership, change the policy beneficiary, and put an absolute assignment on their policy for purposes of transacting a loan.

While policyholders are free to do what they wish with their policies, there are restrictions embedded in some provincial insurance regulations precluding buyers from promoting or arranging the purchase of life insurance policies. The provinces of Quebec, New Brunswick, Nova Scotia, and Saskatchewan do not restrict the trading of policy benefits, while the other Canadian provinces have laws against the "trafficking" in insurance policies.

Taking the province of Ontario as an example, in 2014 the Financial Services Commission of Ontario released a bulletin which is titled "Trafficking in life insurance policies prohibited" which states that "any person , other than an insurer or its duly authorized agent, who solicits or assists Ontario policyholders in the selling, trading, transferring, pledging or assignment of life insurance policies might be in violation of section 115 of the Insurance Act."[ix] In line with this regulation, FSCO has sent cease and desist letters to businesses operating in Ontario that have been involved in the business.

However, in recent years, some of the smaller Canadian life insurance providers have attempted to work with the sector by partnering with businesses in order to complete Life Settlements in all provinces across Canada. This may have been a step toward opening up the secondary market for life insurance in Canada and a pro consumer advancement.

Despite some firms' efforts to work within the framework of existing regulations and purchase policies, some life insurance companies have threatened their agents against assisting their clients with a life settlement, as these insurers prefer to stifle the secondary market rather than increase consumers' liquidity options.[x] This leaves agents in a difficult position between choosing to do what is best for their clients or maintaining the status quo mandated by insurance companies.

Darwin Bayston CFA, former CEO of LISA says "The current stance of Canadian insurers reminds him of the position taken against the US life settlement sector 20+ years ago. Eventually they come around to the consumers way of thinking - either by regulation or by moral suasion."

Did You Know?

1 Insurance companies advertise that policies are an asset that can be used while living: Canadian life insurance companies endorse using Universal Life Insurance contracts to secure loans and provide tax free income while one is still alive. These strategies have been quoted as being akin to setting up a "reverse mortgage" and using the death benefit to eventually pay off the loan. [xii] This type of strategy has less to do with providing insurance as it does with providing policyholders with a tax shelter.

Moreover, many policies are advertised as building Cash Surrender Values which can be used for selling the policy back to the insurance company prior to death. However, the insurance carrier can be the only one buying it back, at their mandated monopoly pricing.

2 Insurance companies market charitable giving strategies where a policy can be gifted to a charity at FMV in return for a tax write-off [xiii] : This is a defacto Life Settlement transaction. The fair market value of the policy based on premiums, death benefit, and life expectancy is calculated, and the charity becomes the new owner and beneficiary of the policy as part of the transaction.

Among industry participants, it is recognized that one reason why the life insurance companies are opposed to these transactions is that it eliminates their monopoly position in the secondary market and decreases easy profits. This is because when a policy is bought in the secondary market, it increases the probability it will be maintained until maturity, and that the insurance company will eventually have to pay out the death benefit. According to Mario Mendonca, a well known Canadian equity research analyst, while "the (life insurance) companies would never disclose" how much profit they make from policy lapses, "lower-than-expected lapses have resulted in very significant experience losses" for the carriers in the past. [xi]

Canadian life insurance companies promote strategies that are both philosophically and mechanically similar to Life Settlements

The reality is that the Canadian market in Life Settlements is far behind that of other countries. For instance, in the United States seniors are already receiving more than $USD 7 million per day through these transactions and the U.S. supreme court recognized them as fully legal in 1911. [xv] The market has grown in the United States to such an extent that 43 states now have regulatory regimes which protect the majority of the country's population under comprehensive laws and regulations [xvi] Moreover, well known institutional investors including Warren Buffet's Berkshire Hathaway and Canada Pension Plan Investment Board have participated in the life settlement market as investors. [xvii]

Call to Action:

The primary responsibility of a trusted financial advisor is simply an ethical decision to inform clients about all the alternatives to lapsing or surrendering a life insurance policy. Available options include:

- Life Settlement and related loan transactions
- Accelerated death benefit or available riders
- Gifting policy to charity
- Policy replacement

Additionally, as the client's real or perceived fiduciary, one's obligations go beyond informing a client of the options. Advisors should ensure that their clients are well protected. When it comes to Life Settlements, this means the following:

- Use multiple criteria to identify a Life Settlement firm to help facilitate the selling of a policy
- Help clients understand the fair market value of their policies and secure the best offer
- Review privacy laws and forms for compliance

There are also many benefits to the advisor for recommending the Life Settlement option which include the following:

- **Enhanced relationships:** Conducting truly holistic financial planning that considers the potential value of all assets in portfolios, including life insurance policies, will help cement relationships with clients and their family members
- **Competitive differentiation:** helping your clients turn unwanted or unaffordable life insurance policies can be a powerful way to differentiate yourself from other advisors
- **Obtain new clients:** by recommending a creative and safe financial planning option to existing clients, you may generate referrals to new clients

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It is incumbent upon advisors to educate themselves regarding life settlements in the same way they would learn about other financial strategies, and the reason is simple: in certain circumstances it could be the best option for dealing with a suboptimal contract.

As with any financial planning strategy, life settlements are not suited to every individual situation, and there can be certain downsides to selling any life insurance policy. The important thing is to determine their applicability to each unique scenario.

Canadian Life Settlements: A Provider of Life Settlements in the Canadian Marketplace.

Canadian Life Settlements consists of a group of Accountants, Actuaries and Lawyers who are dedicated to helping Canadian Seniors get the most out of their life insurance policies.

Our firm's combination of experienced industry professionals works together to help Canadian consumers achieve the best outcome when disposing of unneeded and / or impractical life insurance policies. We offer a variety of secondary market transactions including full or partial surrenders as well as policy loans to qualified consumers. We understand that building and maintaining consumer trust will ensure the industry's long-term success and therefore we endeavor to be transparent and fair in all our transactions.

Canadian Life Settlements has been in operation since 2015 and has provided millions of dollars to Canadian policyholders in exchange for their life insurance policies.

Please visit www.canadianlifesettlements.com for more information on the company.

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End Notes

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