LIFE SETTLEMENT INVESTMENTS: AVOIDING THE PITFALLS IN THE EVENT THE LIFE SETTLEMENT COMPANY FILES FOR BANKRUPTCY

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For those who may be considering an investment in life settlements (see my previous blog for background), recent bankruptcy filings of life settlement entities have raised a concern not often considered when determining whether or not to invest: what would happen if the entity that owns or manages the underlying insurance policy(s) ends up in bankruptcy. Life settlement companies typically include provisions in their purchase agreements that downplay the potential ramifications of a bankruptcy filing. Such companies state how they, or the underlying insurance company, have been in business for many years, that the investor is a beneficiary of the policy, or similar words of comfort. However, these are just words, and they do not in and of themselves provide any protection to the investor.

What are the potential ramifications of a bankruptcy filing? Creditors in a bankruptcy case are paid in the order of priority of what type of claims they hold. Secured creditors enjoy the highest priority of repayment and come before administrative claimant (which are the holders of claims that arise during the bankruptcy case, such as the fees and expenses of the professionals retained in the cases) and have higher priority of repayment compared to priority unsecured creditors (such as the pre-filing claims of taxing authorities) who come before general unsecured creditors (i.e., the lowest level of priority of repayment). In the context of a life settlement, if an investor is not listed as an owner or a beneficiary of a life settlement, he or she will likely be treated as a general unsecured creditor and may ultimately receive only pennies on the dollar of the initial investment.

So, how do you protect your investment? First, read the life settlement purchase agreement carefully, particularly where it states who will be listed as the owner of the policy and who will be listed as a beneficiary(s) of the policy. Typically the company selling you the investment or the entity managing the investment (if any) will be listed as the owner on the records of the insurance company. If you are buying the policy outright, you should be listed as the owner. Period. Require proof before handing over your money to make the investment. If you will be one of several investors in the policy, you should, at a minimum, be listed as a beneficiary on the insurance company records. Make this a condition of your purchase of the life settlement. Again, require proof. Far too often, investors in life settlements find out too late that they have little to no protection and end up on the bottom of the bankruptcy creditor priority list. Take those extra steps and protect yourself before you commit to a purchase.

For more information on this topic, please contact the author, Deborah Talenfeld, on the firm's Business Reorganization Team.

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