CG Analysts

Comprehensive and Forensic Due Diligence in Life Settlements: An Analytical Guide

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Introduction to Life Settlement Due Diligence

The life settlement industry – where policy owners sell their life insurance policies on the secondary market for a lump sum – requires an exceptionally rigorous due diligence framework. For investors and their advisors, the acquisition of a life insurance policy represents a complex transfer of risk. If a policy is improperly originated, non-compliant with state regulations, or based on fraudulent medical disclosures, it could be subject to rescission by the insurance carrier or legal challenges by the insured's estate.

To minimise the chances of rescission or legal challenge and protect investor capital, due diligence should transcend basic administrative checklists. It requires a forensic, multi-dimensional investigation into the policy's history, the parties involved, the medical underwriting, and the jurisdictional regulations governing the transaction. This article deconstructs the due diligence process into five core investigative pillars – Who, What, When, Why, and Where – while also addressing the regulation compliance requirements and closing efficiency.

Part I: The "Who" – Forensic Evaluation of Transactional Parties

The foundation of any life settlement investigation is a granular analysis of the individuals and entities involved in the policy's origination and subsequent history. The primary directive is to ensure that all relationships make logical and legal sense from both the insured's and the owner's perspectives.

The Insured and the Original Owner

The relationship between the insured and the original policy owner will need to be scrutinized to confirm the existence of a valid insurable interest at the time of issuance.

- **Insurability and Financial Justification:** Background checks should be conducted to verify that the insured was financially insurable for the stated face amount. Discrepancies between the insured's actual net worth and the policy size often indicate speculative intent.
- **Third-Party Ownership:** If the owner is not the insured, the exact nature of their relationship should be documented. This includes corporate ownership (Keyman policy) or trust ownership.
- **Trustee Vetting:** When a trust is involved, the trustee should be subjected to rigorous background checks. If the trustee is a legal or financial professional (lawyer, CPA etc.), investigators should search for any history of disbarment, professional sanctions, or regulatory flags. Furthermore, if the trustee is known within the industry as an investor, it raises an immediate red flag for a "beneficial interest trade" policy (whereby the beneficial interest in a trust is sold to a third party to avoid a change of ownership being registered with the carrier), which carries a high risk of legal challenge

The Beneficiary

The beneficiary designation should maintain a logical, documented connection to the insured. Even if a trust is the owner, a personal relationship or legitimate financial connection must exist between the insured and the beneficiary of the trust, which is the ultimate beneficiary of the policy. Lack of such a relationship is a primary indicator of fraudulent life insurance policy trading.

- **Original and Current Insurance Agents:** Was the original agent correctly licensed in the state of issue at the exact time the policy application was signed? Did they hold a valid appointment with

the issuing carrier? Is the current agent still licensed in the state of issue? If not, has a new agent replaced the original one?

- **Variable Life Insurance Compliance**: Variable life insurance policies are classified as securities. Therefore, any agent or broker selling or settling these policies must be regulated by the Financial Industry Regulatory Authority (FINRA). A failure to maintain FINRA compliance renders the transaction illegal under state and federal securities laws.
- **Settlement Brokers and Providers:** The settlement broker and the settlement provider must be actively licensed in the state where the policy owner currently resides (or was resident at the time of settlement). Any history of involvement in Stranger-Originated Life Insurance (STOLI) or bad practices by the broker or provider should be noted and investigated, as it might result in immediate disqualification.

Part II: The "What" – Granular Analysis of Facts and Events

The "What" phase examines the chronological facts of the policy to identify structural anomalies, unauthorized modifications, and medical discrepancies.

Chain of Ownership and Beneficiary

Investigators should map every change in ownership or beneficiary prior to closing. For example, a policy originally owned by a spouse that is later moved into a trust may be a standard estate planning manoeuvre. However, if the new beneficiary or owner has no discernible relationship to the insured, it strongly suggests a non-recourse premium finance arrangement or a beneficial interest trade.

Policy Modifications and Reinstatements

- **Face Amount Adjustments:** Any increase or decrease in the face amount should be investigated. A decrease might simply indicate the owner's inability to afford premiums. However, an increase in the face amount without a corresponding death benefit value (DBV) option or paid-up dividends will trigger a new contestability period for the newly added amount.
- **Reinstatements:** If a policy lapses and is subsequently reinstated, a new contestability period begins on the date of reinstatement. It is imperative to verify if any reinstatement occurred within the last two years, as this exposes the policy to carrier investigation and ultimately to rescission, if the carrier finds any signs of material misrepresentations or fraud.

Medical Underwriting and Clinical Disclosures

As a critical component of the risk assessment, the medical application should be cross-referenced with the insured's actual clinical records.

- **Disclosure Integrity:** Did the insured properly disclose all medical conditions, surgeries, and medications at the time of policy application?
- **Rescission Triggers:** If a life-threatening condition (or a precursor to one) was omitted from the application, the carrier has a strong legal basis for rescission. This risk is exponentially higher if the insured's current (or even future) clinical impairment is directly connected to the undisclosed historical condition.

Part III: The "When" – Chronological Risk and Waiting Periods

Timing is a critical diagnostic tool for regulatory compliance. 44 states and territories regulate both viatical and life settlements (some using the “viatical settlement” terminology, others moved to the “life settlement” terminology), two regulate viaticals only, and six remain unregulated.

Advice should always be sought – the six states that don’t regulate specifically for life and/or viatical settlements, may classify the transactions as securities and regulate them as such.

The State-Mandated Waiting Period

Part of state regulation is the waiting period – the mandated timeframe measured from the issuance of the policy until it can be lawfully settled. While most states enforce a two-year waiting period, some require up to five years.

- **Converted Policies*:** The waiting period rule is more complex for converted policies. In regulated jurisdictions, a converted policy may only be settled if the time covered under the original term policy *plus* the time covered under the conversion policy meets the state's minimum requirement (two, four, or five years).

  **See Part VIII:* Life Insurance Policy Conversion – Settling a Term Policy relating specifically to life insurance policy conversions.

- **Evidentiary Certification:** 38 states require specific certifications from the seller stating that the policy is a result of a conversion and that the cumulative time meets the 24, 48, or 60-month threshold. Florida, notably, requires this certification to be accompanied by strict evidentiary documentation. Due diligence teams should ensure these affidavits are present, accurate, and filed correctly to prevent the settlement contract from becoming voidable.

Indicators of Investor Origination

- **Life Expectancy (LE) Requests:** If an LE certificate was requested before the policy application date, or within the first two years of issuance, it is a strong indication that investors may have been involved at origination or that the insured/owner intended to sell the policy.
- **Serial Sellers:** The discovery of multiple high-face amount policies for the same insured, all being settled immediately after the 2-year (or 5-year) waiting period expires, is a red flag for "serial sellers" who utilize life insurance strictly as a short-term investment vehicle.
- **Medical Records Requests:** if medical records were requested before the policy application date, or within the first two years, it might be an indication that the owner is a serial seller, or that the investors were involved at the time of policy origination.
- **HIPAA documents**: multiple HIPAA documents executed on provider’s closing package, or on policy servicer’s documents, overlapping with the policy application date, or with the policy issue date, might also be indicative of wrong doing.

Part IV: The "Why" – Investigating Motivations and Red Flags

Understanding the rationale behind specific transactional events is essential for uncovering latent fraud.

Premium Financing and Loan Structures

If the policy's premiums were financed, the due diligence team should identify the lender and evaluate their industry reputation. Crucially, investigators must try to determine if any type of agreement existed *before* the owner applied for the life insurance policy. If such an agreement predates the policy, carriers can use this to prove an initial intention to sell, challenging the policy as a STOLI arrangement.

The Redaction Prohibition

Transparency is paramount. Any information redacted on provided documentation is a critical failure of due diligence. Redactions are sometimes utilized to conceal unlicensed insurance agents, misstated social security numbers (SSNs), or illicit commission structures. An incorrect SSN on an application will create significant delays or denials when the insured passes away and a death benefit claim is filed. Therefore, no information should be accepted in a redacted format.

Part V: The "Where" – Navigating Jurisdictional Complexity

The location of the policy issuance, the owner's residence, and the settlement execution creates a complex matrix of regulatory requirements.

Jurisdictional Arbitrage

Opportunistic actors may attempt to bypass strict state laws by establishing trusts in unregulated or loosely regulated jurisdictions. For example, if a policy is issued in Florida (which has regulated life/viatical settlements since 2000) but the owner is a trust established in Delaware (which implemented regulations in 2017) just prior to the application, investigators should scrutinize the insured's actual connection to Delaware. This may be an attempt to evade stricter consumer protection laws, and due diligence should confirm whether the applicant had a legitimate business or family association with the trust's state.

Cross-Border Transactions and Choice of Law

When a policy is issued in one state (e.g., Minnesota) but the insured resides in another (e.g., California), analysts should always check the regulations in effect in both states at the time of issuance. Furthermore, if a policy is settled in one state but the seller resides in another, the due diligence team should investigate and determine the applicable rescission period at the time of settlement and ensure it was properly disclosed.

In scenarios where a policy is owned by multiple individuals or entities residing in different states, a formal "Choice of Law" document is mandatory. This document must explicitly state which jurisdiction's laws govern the settlement. Only eleven states address this issue and specify that the insured state will govern in absence of an agreement between the policy owners.

Therefore, without the proper documentation, the transaction is vulnerable to conflicting state regulations, and the settlement contract may be rendered void.

Statutory Disclosures and Licensure

Analysts should verify that all disclosures provided to the seller and/or the insured meet the minimum requirements of the governing state law. This includes ensuring that broker fees are properly disclosed and that the disclosures are conspicuously displayed in a manner that is easy to read (some states require disclosures on a separate, standalone document). Finally, it must be confirmed that the life

insurance agent (if involved in the settlement), the life settlement broker, and the settlement provider were all actively licensed and in compliance with that specific state's regulations at the time of the settlement.

Part VI: Minimum Payment Requirements

A critical component of the regulatory compliance checklist that the due diligence team must strictly adhere to is ensuring that the purchase price offered is at least the minimum required by the legislation effective in the owner's state, often referred to as the settlement state or closing state.

There are several variables to consider, an important one being whether the insured is terminally or chronically ill.

- Specific guidance: Some regulated states have specific rules governing the minimum purchase price (as a percentage of the death benefit) that must be paid based on the insured's life expectancy.
- Advisory guidance: State regulation may simply stipulate that the purchase price should exceed the cash surrender value and/or the accelerated death benefit rider, if active at that time.

A number of states incorporated this requirement when they adopted their life/viatical settlement regulations. Some added this provision later, either by amending existing regulations or by repealing the entire act and enacting new legislation. As of July 2026, Kansas is the most recent state to implement such legislation, with K.A.R. § 40-2-31 becoming effective in July 2024. Conversely, Minnesota repealed its regulation with regard to minimum payments in August 2009 and has not replaced it.

While this regulatory requirement is often found under state statute, it is frequently codified within the administrative code. Extensive research should be performed to ensure that no requirements are overlooked, thereby mitigating rescission or legal challenge risk. Alternatively, legal counsel should be consulted if the due diligence team encounters difficulty identifying the specific legislative requirements in a given jurisdiction.

Part VII: Mitigating Seller Fatigue Through Efficient Closings

The broker owes a strict fiduciary duty to the policy seller, not the settlement provider or to the investor. Delays in the closing process can cause "seller fatigue," which is particularly detrimental when sellers are relying on the proceeds to fund immediate medical care.

Front-Loading Data and Auction Transparency

To ensure the quickest and most accurate closing, brokers should establish a transparent auction process where all providers are treated equally. Brokers should front-load the due diligence process by providing potential bidders with comprehensive information at the initial stage. This includes the policy document, application, annual statements, updated and complete medical records, updated illustrations, and any available life expectancy (LE) reports. Providing this data upfront ensures better medical underwriting, more accurate pricing, and a faster transition to the closing phase.

Digital Execution: E-Signatures and Remote Notarization

The industry would benefit significantly if the digital execution tools available are fully adopted – ensuring at the same time that the required compliance is met.

- **Electronic Signatures:** E-signatures have been legal and enforceable in US courts since the early 2000s. Platforms like DocuSign provide a secure, compliant, and rapid method for executing closing documents, often offering more security than traditional signatures due to integrated identity verification protocols.
- **Remote Online Notarization (RON):** Many closing documents require notarization. E-notarization allows the notary and seller to sign electronically, attaching the notarial certificate and seal to the electronic record. This is faster and more convenient than traditional in-person notarization. As long as the notary's commissioning state permits RON, the notarization is recognized across state lines.

Accuracy in Documentation

Brokers should always assist clients in completing closing documents with absolute accuracy. No fields should be left blank; if a field is not applicable, "N/A" can be entered to indicate it was not overlooked. Documents must be correctly dated and signed in the appropriate spaces. Furthermore, brokers should make sure that all state-specific closing requirements are met (e.g., Arkansas requires a full description of all offers, counteroffers, and rejections to be provided to the seller and provider).

By ensuring documents are executed flawlessly the first time, the case spends less time in the due diligence review process, eliminating the need for the due diligence team to request fixes and ensuring the seller receives their funds without unnecessary delay.

Part VIII: Life Insurance Policy Conversion – Settling a Term Policy

When pricing and assessing a term policy, an investor's actuarial team may conclude that it is a more favourable investment if the policy is purchased as a term contract and subsequently converted to a permanent life insurance policy. However, recent court rulings indicate that this strategy carries a significant risk of carrier-initiated rescission.

Important factors to consider include relevant U.S. court decisions and the effective legislation in the settlement state at the time of the transaction. Two U.S. courts have delivered conflicting outcomes when policy validity was challenged by the carrier. Although both District Courts (California and New York) initially reached similar conclusions, the United States Court of Appeals for the Ninth Circuit subsequently reversed the California decision.

Ameritas Life Insurance Corp. v. Wilmington Trust, N.A. as Securities Intermediary

In *Ameritas Life Insurance Corp. v. Wilmington Trust, N.A.*, the United States District Court for the Central District of California initially ruled that a converted policy is a continuation of the original term policy and, therefore, does not carry insurable interest risk. Ameritas appealed, and in March 2026, the United States Court of Appeals for the Ninth Circuit reversed the decision, ruling that the Term Policy and the Permanent Policy are distinct contracts. This means the permanent policy is void because the policyholder lacked an insurable interest in the life of the insured at the time the policy became effective.

- **Background:** Ameritas Life Insurance Corp. issued a Term Policy to Amir Moghadam in 2004. Wilmington purchased the Term Policy and applied for conversion in 2024. The district court originally dismissed Ameritas's claim that the Permanent Policy was void for lack of insurable interest, focusing on whether the Permanent Policy constituted a separate contract or a continuation of the Term Policy.

- **Outcome:** The United States Court of Appeals for the Ninth Circuit, exercising jurisdiction under 28 U.S.C. § 1291, reversed the district court's dismissal, supporting the carrier's position that the policy was void for lack of insurable interest.

Zaben, LLC v. John Hancock Life Insurance Company of New York

In *Zaben, LLC, and Weinstock Partners LLC v. John Hancock Life Insurance Company of New York and John Hancock Life Insurance Company (U.S.A.)*, the United States District Court for the Southern District of New York granted a motion to dismiss filed by Zaben on March 27, 2026.

- **Background:** In 2008, Mr. Weinstock obtained a term life policy issued in New York with a conversion option to permanent coverage. The conversion required meeting specific age, risk, and minimum face amount requirements, with no additional medical underwriting. The counterclaim alleged that the term policy was sold to investors, and that Weinstock Partners (a company created by investors) was designated as the owner and beneficiary to conceal investor intent. The investor then exercised the conversion provision to obtain a new universal life policy under New Jersey governance.
- **Outcome:** The court granted the plaintiff's motion to dismiss the defendant's First Amended Counterclaim.

Effective Regulation in Settlement State

As part of the required disclosures provided to the policy owner before a life settlement agreement is executed, 43 regulated states mandate that the settlement broker and/or settlement provider inform the seller of the potential risks associated with selling a life insurance policy. One such risk is that entering into a life settlement contract may cause the owner to forfeit other rights or benefits, including conversion rights that may exist under the policy. Consequently, it is vital that state disclosure requirements in effect at the time of the transaction are verified to ensure the investment is not at risk of rescission by the carrier for lack of insurable interest.