Life Settlements– An Idea Whose Time Has Come

By Bill Gradison

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The new year brings new opportunities to serve your clients — including seniors to whom you have sold life insurance in the past but whose coverage needs have decreased because circumstances have changed.

Recent estimates show that each year owners of more than $100 billion of life insurance policies either will have an active interest in selling or no interest in owning their policies. Most of these owners are not aware of their liquidity options beyond their policies' cash surrender value.

> **“Plain vanilla is out, tailored financial planning is in. It is in the interest of many clients — and therefore in the producer’s interest — to learn about and use life settlements.”**

This has begun to change. Since 1997, when some companies began offering life settlements, it has been estimated that well in excess of $1 billion in policies have been purchased.

In 2000, Patton Boggs began representing Stone Street Financial, a newly formed company specializing in life settlements. Life settlement companies purchase policies covering the lives of insured seniors with a life expectancy of more than two years who do not have a terminal illness (“life settlements”). In contrast, viatical settlements, which the life settlement company does not purchase, are for per-

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sons with terminal illnesses and usually with life expectancies of two years or less. The life settlement company pools the policies it purchases, reinsures them, and the pools serve as collateral for a bond (i.e., are securitized).

Using the life settlement company's criteria as examples, here are answers to questions both policyholders and producers often ask.

1. What is a life settlement?

In its simplest form, a life settlement involves the sale of an in-force life insurance policy where the insured is at least age 65 in return for consideration greater than the policy's cash surrender value, and less than the policy's face amount.

2. Why would a policy owner want to sell his or her life insurance policy?

A life insurance policy is the owner's property. A policy may be sold when the owner has determined that he or she no longer needs the policy. This may arise in circumstances such as business-owned policies where the insured no longer is connected to the business, or where the insurance proceeds no longer are needed to pay estate taxes or final expenses. The contract may be sold for any reason the owner may desire.

3. What kind of policy will the life settlement company purchase?

The life settlement company will purchase whole life, universal life and convertible term policies.

4. Who will be responsible for premium payment after the policy's sale?

The life settlement company will be responsible for all premium payments after the sale is closed.

5. Is the process confidential?

Yes. No medical, financial or other personal information that the life settlement company obtains as a result of the transaction will be disclosed to any other person or entity not a part of the process without specific written consent, unless required by law.

6. Are there restrictions as to how the funds may be used?

The life settlement company places no restrictions on how the funds are to be used after the contract is purchased.

7. How does a life settlement work?

The insured — and the contract owner if different than the insured — submits an application through a financial partner to the life settlement company with a copy of the insurance policy. The life settlement company obtains an in-force illustration of the policy from the issuing insurer showing the face amount, outstanding loans and premiums due.

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The life settlement company also obtains copies of the insured's medical records directly from the insured's physicians. The life settlement company reviews the records to determine if the insured meets its guidelines to make an offer on the policy.

When an offer is made and accepted, the transaction is documented and it proceeds to closing. An escrow account ensures that the policy's owner receives the purchase price. In most cases, the policy's seller has the right to rescind the transaction within 15 days of the closing so long as the purchase price and any premiums paid by the life settlement company are returned.

8. How long does it take to complete a transaction from start to finish?

The life settlement company's goal is to complete most transactions within 30 days. The most significant delay is the need to review and evaluate the insured's medical records carefully. Obtaining these records may take some time.

9. Does the client have to sell all of his or her life insurance?

No, he or she may sell as much coverage as he or she desires, provided that a minimum policy size of $250,000 is met.

10. How much will the owner be paid for the policy?

The amount paid to the policy owner depends upon a number of factors, including the insured's life expectancy, the amount of premiums needed to be paid to keep the policy in force and the policy's cash surrender value.

11. Are the proceeds from a life settlement taxable?

The proceeds from a life settlement usually are tax-free up to the amount invested in the policy. The difference between that amount and the cash surrender value usually is taxable as ordinary income. Amounts received exceeding cash surrender value usually are taxed as capital gains. Sellers should consult their own tax and financial advisers before completing a transaction so they can determine the tax effect on them from the sale.

12. Is it OK to sell and buy life insurance policies?

Yes. When a life insurance policy is issued and put in force, it is the contract owner's property. Much like any other asset, the policy owner has the right to dispose of the policy in any manner that he or she chooses. Options include holding the policy until maturity, surrendering it for its cash value, lapsing the contract or selling it for an amount higher than the cash value, but less than the face amount.

When deciding whether to discuss life settlements with older clients, producers should ask if the client:

- Plans to lapse the policy?
- Plans to surrender the policy?
- No longer needs the policy?
- Plans to retire or sell interest in a business?
- Has changed estate tax needs?
- Has to pay premiums he or she no longer can afford?

If the answer to these questions is yes, the client may no longer need life insurance. In other cases, a review of a client's situation — family, business, financial — may disclose that the need for life insurance still exists, but that a new, more cost-efficient policy should be considered.

In terms of compensation, producers may:

- Receive competitive fees for closing a life settlement.
- Maintain their renewal income if they are the producer of record.
- Receive conversion commission if the term policy is converted.
- Earn commissions for investments and annuities from the dollars invested from the life settlement.
- Earn new life commission (usually

an individual policy to a survivorship policy).

Producers should look for the following in a life settlement company:

- Strong compliance program.
- Strict business standards for treatment of consumers.
- Institutional funding source(s).
- Institutional servicing arrangements.

The financial services field has changed dramatically since I entered it many years ago, mainly in the range of new products and services. As always, the great challenge — and the great opportunity — for professionals is to match clients' changing needs with the appropriate product. Plain vanilla is out, tailored financial planning is in. It is in the interest of many clients — and therefore in the producer's interest — to learn about and use life settlements.