

## **Life Settlements – What’s all the Buzz About?**

*By Nate Williams*

Recently, you may have been hearing more and more about life settlements, and wondering, what are they? Life settlements are a new way for you and your client to look at a life insurance policy. Some life insurance policies can be transformed into an unexpected source of income, freedom and flexibility — all for enjoyment while your clients are still alive.

A vibrant secondary market for life insurance policies, populated by major institutional investors searching for diversified investment options, has come into being. That means that hidden in your client’s safe deposit box or bottom drawer may be an under-appreciated asset.

Life settlements are relatively new to the life insurance marketplace. Until recently, policy owners of unwanted coverage had limited alternatives — they let policies lapse or surrendered them for cash value. But now, the incumbent insurance carrier no longer holds sole control over the options clients have with their life insurance policies. Clients may now be able to sell their policy in the secondary market for far more than the cash surrender value the insurance carrier would offer.

Life settlement empowers policy owners to view life insurance as an asset, rather than as an expense. When a life settlement is used, policy owners receive market value for their life insurance policies and no longer have an ongoing premium commitment. As such, life settlements have become an important financial tool for managing investment portfolios.

### **Who is a candidate for a life settlement?**

Not everyone should sell their life insurance policy, but it’s a good idea for agents to help their older clients evaluate a life settlement as part of a wealth management strategy. Life insurance is a valuable product and serves an important purpose in one's financial portfolio. Oftentimes, however, people's needs and circumstances change, while policies don't. For those who no longer want to maintain coverage, or for whom premiums have become burdensome, life settlement may provide substantial benefits.

When a policy is no longer needed, the life settlement marketplace offers an important alternative to "cashing in" or letting a policy lapse. Outlined below are examples of situations that may create an opportunity to reconsider the necessity of a life insurance policy.

- A safety net for beneficiaries is no longer needed due to lifetime wealth accumulation, changes in marital status or the maturity of children.
- The policy owner is over-insured or wishes to dispose of an existing policy to execute a more appropriate one.
- Sale, dissolution or bankruptcy of a business eliminates the need for key-person policies or buy-sell agreement coverage.

- Tax law changes have reduced the need to subsidize estate taxes.
- A family or medical emergency arises.
- Insurance policy premiums have become unaffordable.
- Business loans secured by the policy have been repaid.
- Stock market volatility has diminished retirement income.
- A need exists to fund a long term care program.

The ideal life settlement candidate is a person over age 65 who no longer requires the death benefit of a life insurance policy. In fact, those who choose life settlement are usually individuals whose abilities have brought them a certain degree of affluence. But any policy owner, including individuals, corporations, charities or trusts, may sell any life insurance policy, including group and term policies. Policies are sold to qualified buyers for the present value of the net death benefit. The buyer maintains the policy, paying the premiums and eventually collecting the death benefit.

For example, a 67-year-old physician is diagnosed with cancer, causing him to reconsider his retirement strategy. He elects to use life settlement to enhance his investment portfolio. His life insurance policy has a net death benefit of \$801,000, and his insurance carrier offered him a surrender value of \$78,000. Multiple quotes were obtained from institutional investors in the secondary market, negotiating a final offer of \$363,000. This dramatic infusion of funds was the primary factor in enabling him to enjoy retirement immediately.

### **Regulation of life settlements**

The National Association of Insurance Commissioners' (NAIC) Life Settlements Act provides a seamless system of effective nationwide regulation by creating standards for how life settlements are conducted. However, the amount of regulation imposed by state insurance departments varies from state to state.

### **How much money will the client get if he sells his life insurance policy?**

The value of a life insurance policy is determined by a number of factors, including, but not limited to, the age and medical condition of the insured, type of insurance policy, rating of the issuing insurance company, the net death benefit and the amount of premium payments to keep the life insurance policy in force. Typically, a life settlement is about three to five times the cash surrender value of the policy.

### **What types of life insurance policies can be sold?**

Most types and forms of life insurance policies can be sold. However, the most common are universal life, whole life and convertible term life. These policies typically have a \$250,000 or greater face value, were issued from an insurance carrier rated "A" or better by A.M. Best, and have been in force for at least two years.

### **Are the proceeds of a life settlement taxable?**

The proceeds are generally tax-free up to the amount the client has paid in premiums during the life of the policy. Whether and how the balance of proceeds will be taxed depends on the client's specific situation; typically, though, the amount of the payout over

and above the cash value is taxed as capital gains.

**How long does the process take?**

The process typically takes about 30–90 days.

**What else you should know**

Before seeking life settlement, we recommend that agents work with someone with extensive industry experience and who can also provide a turnkey program. A good organization for life settlements should be able to offer a fully transparent process and produce multiple bids so the client can choose the best bid. The life settlement company should be operating with high standards, and be fully compliant with all state regulations and NAIC standards.

Life settlements hold tremendous opportunity for agents. Agents have the potential to retain renewal commissions on the life insurance policy, earn commission on the life settlement transaction, and possibly earn commission on the sale of new products the client may purchase with his “new-found” money.