

# The *Producer's* Role In a *Life Settlement*



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**L**ife settlements are a hot topic in today's uncertain economy. When the need for insurance becomes less important or disappears altogether, life settlements can be the solution clients need. Producers can recommend this option to clients and in the process not only emphasize that they have their clients' best interests at heart, but also earn up to three separate commissions in the arrangement.

We asked experts from top life settlement and financial services companies to explain how life settlements can benefit both clients and producers. Here are their responses.

**Matthew H. Knepper, marketing director, Ideal Life Insurance Redemption, Wall, N.J.:** During stressful financial times, people look for options to help them get through while keeping their savings and other investments intact. One option is a life settlement.

A life insurance settlement enables a policy owner to sell an existing life insurance policy to a financial institution in exchange for an immediate lump sum cash payment, which is a discounted percentage of the policy's value.

Basically, this enables people to use their life insurance policies as living benefits, allowing them to use their money when they may need it the most — to pay for needed health care, medical procedures, or other personal financial issues.

A life settlement enables a redemption company to redeem a policy to multiple financial institutions to get the highest amount available on its face value. The

amount varies between 20% and 80% cash back on a policy's face value.

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Factors that contribute to the amount of compensation received include the face value, the insured's estimated life expectancy, outstanding loans against the policy, the policy's cash value, and premium payments required to keep the policy in force.

Policies purchased can be government-issued policies, term life, universal life, survivorship policies, corporate-owned life insurance,

and whole life. Face amounts usually are \$20,000 or more.

As far as privacy is concerned, infor-

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mation is given only to licensed funding companies, which make offers to purchase the policy. Producers should use a company that is recommended by the Better Business Bureau.

Consumers face skyrocketing health care premiums and the financial burdens of long-term care. A life settlement can help someone regain control of his or her financial stability. A life insurance policy is personal property; like a house or car, it can be bought and sold.

As life insurance premiums rise at the same time as health care premiums, people find themselves in a position where they no longer can afford to pay these premiums, leading to a policy lapse. After a policy lapses, there is no way to gain back money invested in it. Instead of that, the producer can offer a life settlement to his client and, in most cases, do a replacement, benefiting all parties.

Other people simply are over-insured, making this a perfect option to cash out and replace their policies with lesser coverage. Some of the producer's clients may have life-threatening illnesses that are chipping away at their savings. Knowing that they can use their life insurance policy as a living benefit will ease their financial and mental stress.

In certain instances, the producer's client simply may be out of funds, and this option will prove the producer's due diligence to the client by putting money back in his pocket in his time of need. Best of all, a few settlement companies offer this option for free and with no obligations, even if the producer's client declines an offer.

The producer has only a small physical role in the process. His job in this case merely is getting the referral and helping the client unlock the financial benefits. The life settlement company does all the other physical "foot work."

The benefits to the producer are numerous. First, he can pursue due diligence for his clients. Second, the producer will earn a handsome commission on any closed settlements he referred, as much as three points of an insurance policy's face value. In most cases, he also will re-insure his client and make a new commission from the replacement.

Life settlements may not be the right option for everybody, but many people have saved their homes, increased their net worth, kept their savings, received medical care, and eased their financial peace of mind by unlocking the benefits of this underused financial option.

### **Scott Butterworth, Mutual Service Corporation, West Palm Beach, Fla.:**

The burgeoning secondary market for life insurance policies has spawned significant dual benefits. Clients have exciting financial options from which to choose, and an important new mix of responsibilities and sales prospects have been imparted on producers. Many secondary market proponents advocate that life settlements will change how financial professionals approach life insurance as dramatically as mutual funds changed how people invest in stocks. Like mutual funds, this powerful innovation offers the producer an exciting way to grow his practice.

By most accounts, the market for existing insurance policies is huge. A recent study by actuarial firm Milliman & Robertson found that 89.5% of universal life policies never result in a death claim. Further, many of those policies belong to people who have outlived the original necessity for their insurance.

In some instances, the estate may have become smaller, and in others maybe the business partnership has dissolved or a key employee has retired. Still other policies simply aren't performing in today's low-interest, bear-market environment. Regardless of the reason, at some point, many policy owners want out of their policies and are turning in increasing numbers to the secondary market to realize the market value.

As an example, consider a 65-year-old client in good health who buys a \$2 million universal life policy at preferred rates. Suppose that 10 years later, when this policy has a cash surrender value approaching \$60,000, he develops a medical condition that shortens his life expectancy.

While his health has become worse than average, his insurance company cannot charge him extra because of his declining physical condition. His option to continue his policy at rates that were established 10 years earlier now has a measurable, actuarial value.

In fact, his policy now could be worth \$115,000 in the secondary market. This opportunity converts the insurance policy's "at-risk" component from a risk management tool into a tangible financial asset with an immediate market value. A policy's market value far can exceed its surrender value.

Before the advent of this secondary market, life insurance policies could not readily be sold, making it irrelevant to

speaking of a policy's market value. But this recently introduced market for policies has bestowed on every policy a fair market value not unlike the owner's other financial assets. That change confers at least the following major consequences onto producers and their clients:

- When taking inventory of the market value of a client's assets, the producer should take into consideration the fair market value not only of stocks, bonds, and real estate, but also of life insurance policies.

- In estimating death taxes, it will be prudent to consider whether the IRS will value any life insurance policies on others' lives at their fair market value.

- In advising clients how to exit from an unwanted insurance policy, the producer will be obliged to consider whether a life settlement at fair market value is the most suitable choice.

Determining a policy's market value should be included in the planning process for clients aged 60 and older. As life circumstances change, this valuation helps the policy owner understand the policy's potential market value.

A policy's revaluing can be useful when:

- A company officer's retirement makes a key person policy superfluous.

- A partnership is acquired that has a buy-sell agreement funded by life insurance.

- A loan secured by life insurance has been paid in full.

- A policy's poor performance causes a cash drain.

- Divorce or bankruptcy changes the risk against which the parties have insured.

It would be reasonable for financial advisers to consider valuing policies whenever a life event causes a client to reassess his or her holdings.

According to Conning and Company, a provider of research publications on the insurance business, secondary market transactions in 1999 totaled slightly less than \$1 billion. In 2003, such transactions totaled more than \$3.5 billion. Further, the current potential of the United States market is estimated to be \$100 billion at maturity.

A study by several economists at the Wharton School of the University of Pennsylvania that was published in the Fall 2003 *ABA Real Property, Probate and Trust Journal* concludes that in 2003 alone, the secondary market enabled

consumers to receive \$336 million. This represents \$242 million above the total cash surrender value to which they would have been entitled had they tendered their policies back to their insurance companies. Remarkably, this is nearly four times the cash value.

The secondary market creates an extraordinary opportunity for financial advisers. It is changing how clients look at their insurance assets. Financial professionals must understand this new market and both the opportunities and obligations it brings to them as advisers and fiduciaries.

Bank and trust companies quickly are becoming aware of the policy valuation option. Today we find that even attorneys and trust officers recognize a fiduciary responsibility regarding this transaction. Most probably, these professionals believe there is a potential liability if they do not make these important options available to their clients when evaluating a trust's assets.

A benefit for financial advisers is that the more a policy is worth in the secondary market, the more a client will have to reinvest. It has been my experience that two out of five valuations result in a new product sale. Some of these clients use the proceeds to buy annuities, others opt to buy more efficient life insurance policies, and still others pick up additional investment assets.

Regardless of how life settlement funds are reinvested, the producer's clients probably will come away with a more solid financial plan and will have extracted all of the value from an asset they likely had undervalued. And as the producer watches his practice grow, he will have the satisfaction of knowing that he provided the right advice.

**William Scott Page, president and CEO, The Lifeline Program, Fort Lauderdale, Fla.:** Life insurance settlements, or "life settlements," traditionally have been performed for the terminally ill, but under the right circumstances, they can be extremely useful for healthy, high net-worth seniors.

An elderly policyholder may sell a term, whole life, universal life, variable life, or joint/survivorship life insurance policy for a percentage of its face value. This percentage is based on a projected life expectancy. A life settlement may prove desirable for many reasons, including changes in business or life situations, estate-planning or insurance needs, or tax liability.

Producers also should look to life settlements for their clients in the following situations:

- *Under-performing policy.* A client may be served better by selling the policy for cash and investing the proceeds in another manner, such as a policy that better meets his or her needs.

- *Policy no longer needed.* If a beneficiary passes away, children grow up and become independent, or the policyholder experiences an unforeseen need requiring immediate funds, a life settlement may be necessary.

- *Policy too expensive.* If a policyholder no longer can afford premium payments, selling it to a life settlement provider can help recover some of the policy's value.

- *Business change.* If a business no longer needs a key-person policy that was purchased for an executive, selling the policy will provide immediate funds for the bottom line.

- *Change in tax liability.* Policies purchased to pay estate taxes no longer may be necessary, given the recent repeal of the estate tax.

- *Need to fund long-term care.* If a client is planning for such issues as funding long-term care, it may make sense to sell a life insurance policy and purchase a long-term care policy.

- *Qualifying for Medicaid.* An insurance policy may be the only asset preventing a client from qualifying for Medicaid. Proceeds can be put into an instant annuity so that it no longer is considered an asset.

For the most part, the settlement company manages a life settlement transaction, but producers can help in several ways. The first is by assisting the settlement company in walking the client through the transaction's steps. Because producers have personal relationships with their clients, they are in a strong position to help answer questions and educate the clients about the transaction.

Of equal importance is assistance with obtaining records and acting as a liaison when necessary. The settlement company will need copies of the client's medical records (for determining life expectancy), a copy of the original policy and premium schedule, verification of coverage, and a copy of the original application (to double-check for prior conditions). Difficulty in obtaining these records is the main reason that life settlement transactions are delayed.

Producers can reap many benefits

from a life settlement transaction. Aside from the financial benefits, a settlement can help the producer in many ways. Simply by offering it, producers immediately have differentiated themselves from much of their competition. This remains a relatively new business, and those who understand life settlements and offer them are at the leading edge. In addition, producers can be heroes for their clients because they are taking a non-performing asset and turning it into a fantastic investment.

Life settlements also can be lucrative for producers. Providers pay commissions to producers who refer clients, and some producers even can triple dip. In one instance, the writing producer on a policy helped his client sell the policy because it no longer was needed, and the producer continued to earn residual commissions from the original policy because the settlement company continued to pay the premiums.

The producer earned a commission on the life settlement itself and helped the client invest the proceeds in more appropriate insurance — thus earning three commissions plus residuals. It is not uncommon for producers to earn commissions for settlements that later are used to purchase other insurance products.

**Jim Quance, The Life Settlement Alliance, Inc., Fort Lauderdale, Fla.:** The secondary market has become aware of a forgotten asset: clients' life insurance policies. It seems like everyone from time to time has some form of property appraised, so why not life policies? Producers can be creative, and at the same time they will be doing their fiduciary duty by offering life settlements to clients who are 65 or older and looking to surrender, lapse, or perform a Section 1035 exchange of their current policies.

All kinds of insurance qualify. Also, several business applications for which to look are: when a buy/sell agreement no longer is needed after the sale of a company; when purchasing a minority interest in business; when bankruptcy creates the need for liquidation; when key-person insurance no longer is needed; or to pay off company debt.

Anyone older than 65 whose circumstances have changed since the original policy was issued may qualify. Some of the reasons for looking into life settlements are that a client's health has declined or the client has experienced personal or financial changes.

How can this help the policy owner?

Life settlements can fund more cost-effective coverage, pay off a debt, provide funds for a charitable gift or gifts to family members, create funds to invest elsewhere, purchase long-term care insurance or an annuity, or create a more comfortable retirement.

Clients who qualify for a life settlement can see the highest offer in the secondary market and add pure bottom-line dollars to their estate. Those who don't qualify will learn the total liquidation value of an asset, and they can recalculate their net worth after knowing their true financial picture. This is a free, non-binding appraisal.

Producers always should have life settlements in position when the need arises. They should look for under-performing policies within their offices or clients whose policies are in danger of lapsing or surrendering and spread the word to estate-planning attorneys, Certified Public Accountants, and fellow financial professionals.

Life settlements offer benefits for the producer. He has created new capital for his clients that can be used to sell more needed or cost-effective life insurance, reduce lapse rates, offer a creative valuable service to clients, receive additional commissions through referral programs, and keep renewal/trailer incomes.

Financial professionals have an exceptional opportunity in the life settlement market. This option enables them to assist clients in a way never before available. A life settlement gives policy owners a more desirable alternative to surrendering a policy or letting it lapse.

Financial and estate planning needs are changing constantly, and the demand for more flexible financial tools is evident and increasing quickly. Life settlements can help producers meet these demands with great monetary benefits to themselves and their clients. This represents an opportunity for today's financial planners, life producers, estate consultants, and other professionals who assist older people and their families in meeting long-term arrangements.

Producers should look at the following definitions and see which one best fits specific clients' situations:

1. *Surrender*: To yield possession of or power over to another because of demand or compulsion; to give up or relinquish, especially in favor of another; resign; abandon.

2. *Lapse*: To become void, usually by

disuse or neglect; a fall to lower form or state; to be forfeited to another because of negligence, failure, or death.

3. *Sell*: To transfer to another for a mutual consideration.

4. *Sale*: The exchange or transfer of property for money or its equivalent.

As these definitions illustrate, life settlements can be a fit within all producers' financial tool belts.

