

A Tale of Life Settlements

By David Goodwin

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Here's the situation: Client Jerry Jones was unhappy with his Universal Life policy. At age 62, he had a serious heart condition. For \$650,000 face amount he was paying \$8,400 annually, but the cash surrender value was only \$2,000. Jerry wanted to drop the policy because of its poor performance. He asked some agents what to do.

"Renew it," insisted agent A, who wrote the policy. Agent B advised Jerry to buy a new policy from him and drop the old one, using its cash value toward the new policy. Agent C advised Jerry to sell his policy through a life settlement firm and put the money toward a new rated policy he offered.

Which agent offered the most attractive solution? As it turned out, agent C did. Jerry received \$169,000 for his policy with its \$2,000 cash surrender value.

If you were agent A or B, would you have a strong defense for your advice? This isn't a theoretical exercise; it's based on a true story. Many more like it are occurring.

What is a life settlement, and why is it important to Life and P/C agents?

A life settlement is the sale of an existing life policy to a nonrelated party at a discounted price. The seller, for various reasons, might not want to keep the policy any longer, might not be able to afford it, might not need it, or may simply prefer to get cash right away. The policy may be Term, Cash Value, Group, or Individual. The insured might or might not be healthy, but as a general rule of thumb, their life expectancy should be about 15 years or less and the policy face should be about \$100,000 or more.

The concept is important to a huge and growing market. A recent report by Conning & Co. says this market is "set to explode in the next decade" as more healthy seniors look to sell their policies. Conning estimates the market at over \$100 billion of Life insurance as aging baby boomers use this new financial instrument for additional flexibility. "With more than \$492 billion in Life insurance in force, the 65-and-higher population represents an enormous marketing opportunity," says Conning, with many seeing the transaction as a financial boon, especially if they have a Term policy that they may otherwise view as worthless if it's dropped.

Formerly labeled "viaticals," the industry has come a long way. Viaticals are now generally defined as those involving life expectancies of 24 months or less; "life settlements," two years or more. The early days of viaticals were riddled with scandals. Fraud was committed, wild promises were made, some investors were hurt, and some firms were closed. Normal care is still needed, as in any transaction, but now legitimacy prevails. Insurance companies are among those buying the policies and holding them as investments.

When they first hear of life settlements, many agents don't know the common situations in which the concept applies. These are some of the reasons policy owners - individuals, corporations, trusts, or charities - sell their policies:

- The policy's performance is poor.
- Premiums become unaffordable, or a lower premium or better-suited policy becomes available.

- The coverage is no longer needed or the need no longer exists, such as coverage on a paid-up mortgage or for kids who are no longer dependent, or for a key corporate officer who retires, or for estate liquidity when liquidity has been achieved.
- The beneficiary has died, and there's no apparent potential beneficiary
- Retirement or disability changes priorities or plans.
- Accumulating interest on policy loans starts to choke the value of the policy.
- The need for immediate cash outweighs the need for payment to the beneficiary.
- The investment potential of a cash settlement seems more attractive than maintaining the policy.
- The owner is a nonprofit organization that prefers current cash.
- Policies funding buy-sell or corporate stock-redemption plans are no longer needed.

Here are some real-life cases:

- A 64-year-old female had a \$500,000 policy with \$75,000 cash surrender value. She received \$190,000, and the agent got a referral fee of \$7,500 (1/2% of policy face value).
- A 68-year-old male had two Term policies totaling \$6 million face and an annual increasing premium of \$102,500. He received \$270,000, and the agent's referral fee was \$60,000 (1% of face).
- An 84-year-old female who lived in a nursing home had a policy with \$1 million face, cash surrender value of \$200,000, and an annual premium of \$15,303. Her family received \$520,000.

Many agents can identify situations that would be best served by life settlements. Failure to inform clients about them, when appropriate, may be a terrible disservice. It may also deprive the agent of a huge fee (some have been reported in the six-figure range), cost them some important clients, or even lead to E&O claims.

Life settlements can help your agency demonstrate its professionalism. People generally want to hear about new concepts, whether for immediate or possible future use. They ought to hear about them from you first. Also, agents may also use this tool at seminars for lawyers or accountants - for example, for Commercial accounts.

I suggest that agents, especially those in P/C and Life, add a question or two to their standard fact-gathering forms to identify potential prospects for life settlements. They also might provide clients with a simple outline of life settlements to prompt them to call for further information. Some agents hesitate to handle a product unless they know it thoroughly. Learning about life settlements shouldn't be difficult. The concept is simple, the paperwork is clear, and information is available in seminars or on an individual basis.