

Why Would Someone Sell a Life Insurance Policy?

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Why would someone sell a Life Insurance Policy? Two words: changing circumstances. Typically, an insurance policy is purchased for a particular reason. For instance, a policy on the life of the head of a household may have been purchased as an income replacement vehicle; a policy on a "key person" in a closely-held business may have been purchased to ensure the company's survival following such person's death; or a policy may have been purchased solely as an investment vehicle. But surely enough, circumstances change and the policy becomes obsolete for a variety of reasons, such as:

- The head of the household has accumulated enough wealth so that he is essentially "self-insured."
- The key-person policy is no longer necessary because the business has matured to the point where its fortunes are no longer dependent on any one person or the business has been sold.
- The premiums on the "investment" policy have become so expensive that it is no longer economically feasible to continue funding it.

There are dozens of other circumstances that might lead a policyholder to conclude that it is no longer advisable to keep a policy in place. For example:

A policyholder may wish to sell a policy that has become unnecessary because:

- It was intended to fund a buy-sell agreement and the business has been sold to an outsider;
- It was purchased to ensure the availability of funds to pay off a mortgage and the mortgage has been paid; or,
- It was purchased to provide cash in order to fund estate tax at the death of the insured and the insured's estate has substantially decreased in size through lifetime transfers or otherwise, or the estate has become sufficiently liquid.

Often times, a policyholder may feel that the benefits from selling an in-force policy outweigh the need to keep the policy. For instance, the policyholder may choose a Life Settlement to remove the policy from his taxable estate (avoiding application of the three-year rule under Section 2035) in order to transfer additional assets tax-free to his descendants. Alternatively, a policyholder may use the proceeds of sale to:

- Replace property donated to a charity
- Pay for the costs of health care
- Purchase long-term care insurance
- Replace a single-life policy with a joint and survivor policy
- Pay gift tax on lifetime gifts

- Purchased a more efficient, more affordable policy

Lets look at the following Life Settlement examples:

Client Info: Male age 91, Female deceased

Policy Info: \$950,000 Second-to-Die Universal Life

Surrender Cash Value: \$211,000

Proceeds from the Life Settlement: \$330,000

Use of Proceeds: Proceeds were used to fund an Immediate Annuity.

Client Info: Female age 82

Policy Info: \$8,500,000 Variable Universal Life

Surrender Cash Value: \$70,000 with a loan of \$800,000

Proceeds from the Life Settlement: \$2,045,000

Use of Proceeds: Client was going to surrender the policy but instead used the proceeds for various investment opportunities.

Client Info: Male age 85, Female age 82

Policy Info: \$2,000,000 Second-to-Die Universal Life

Surrender Cash Value: \$133,966

Proceeds from the Life Settlement: \$483,500

Use of Proceeds: Proceeds were used to fund a new Second-to-Die Universal Life with zero premiums for three years.

Once a policy owner has absolutely determined that it no longer makes sense to continue holding a policy, selling the policy may be economically advantageous relative to surrendering or lapsing the policy. Of course, factors such as disappointing investments performance, resulting in the need to pay premiums over a period longer than anticipated, may, under some circumstances, further impel an insured to consider a Life Settlement. Although clients age 65 and older qualify for Life Settlements, the general rule a thumb is if you have clients age 75 or older, a Life Settlement should always be considered if your clients are surrendering a policy or involved in a 1035 exchange.