CALIFORNIA BROKER

VOLUME 23 NUMBER 11 SERVING LIFE/HEALTH INSURANCE PROFESSIONALS & FINANCIAL PLANNERS OF CALIFORNIA AUGUST 2005

Life Settlements Offer a New Alternative When Cashing In Key-Person Policies

by Larry Simon

Many small and medium-sized businesses rely on one person's business savvy to keep them afloat. The company sinks if that person leaves. Companies often purchase "key-person" policies to safeguard the business' human and financial assets if its key executive dies prematurely, retires, or leaves the organization suddenly.

When an insured key person retires or resigns, the company typically cancels its corporate-owned policy and takes the cash surrender value if any is remaining. Life settlements (also known as high-worth transactions) offer the company a new, viable, and attractive option: sell the policy, be rid of any future premium obligation, and receive a lump sum of cash well above the cash-surrender value.
Life settlements can help companies deal with several possible scenarios.
In some cases, when a key employee retires, the company offers to transfer ownership of the key-person policy to the retiree. Such an offer is often declined, because the retiree does not need the policy or the obligation of making high premium payments.

There may also come a time when the key-person policy is no longer needed: the key executive may become less critical to the business because the aptitudes of other executives have improved or the business is sold.
Key-person policies often become assets of the new entity when a business merges with another or is acquired. Key executives of the acquired business may not be key executives in the new business. In the past, companies facing these situations were left with three choices, depending on the type of policy:

1. Recover some of the investment and surrender the policy for its cash value.
2. Allow it to lapse and write off years of premium payments as a necessary but unrecoverable business cost.
3. Continue to pay premiums on the policy until the death of the insured person.

A better alternative is to investigate the advantages of selling the policy through a life settlement broker. If the policy has cash value, the sale may be likely to provide more than the cash value. If a term policy qualifies for sale, funds can be obtained from a policy that previously had no intrinsic value.

How Life Settlements Work

Life settlements are based on the proposition that some insured people no longer want their coverage, need it, or can afford it. Instead of selling the policy back to the issuing insurance company at less than market value or allowing the policy to lapse and forfeiting the value, life settlements allow another exit option that can maximize the cash value for the policy owner. Consequently, life settlements have quickly developed into a viable and attractive alternative product.

In a nutshell, the life settlement process works like this: a life insurance policyholder sells the benefits of the policy to an investor. Most investors do not negotiate with policyholders directly. They provide financing for life-settlement companies that facilitate the buying of the policies. According to a June 5, 2003 article in USA Today, about 25% of key-person policies can be sold to institutional investors in the secondary market. Policies that life settlement companies consider for purchase must meet certain eligibility requirements, such as the following:

- The policy must be beyond any carrier or statutory contestability period, fully renewable, and subject only to the payment of premiums.
- The insured's life expectancy must be between 25 and 144 months based on one or more medical evaluations from an approved evaluator.
- Term policies must have a minimum term life insurance coverage that is equal to the greater of two times the life expectancy, or 10 years.
- The face value of such policy cannot exceed $20 million.

If the company accepts the life settlement company's offer, it relinquishes ownership and beneficial interest in the policy in exchange for a cash payment. As the new policyholder, the investor must maintain all premium payments to keep the policy in force. The concept is much like the buying and selling of mortgage contracts. In this instance, an insurance contract is bought and sold. The investor acquires the beneficial interest in the contract and the obligation to provide for servicing and administration of the contract.

The market opportunity exists primarily as an alternative to surrendering the policy. These surrender values are often so low that a qualified life settlement provider company can pay a higher value.

Finding the Right Life Settlement Company

Policy owners should insist that their agents and brokers perform due diligence by gathering information from several competitive life settlement companies and targeting those whose senior management has had the most life settlement experience. A German company, known as Scope Group, has become active in rating and ranking life settlement companies. So far, it is the first and only company to do so. Scope offers information on its Web site at www.scope-group.com. The settlement broker or agent should seek companies with an A-rating or higher.

The future looks good for the life-settlement industry, which has grown significantly in recent years. The Life Settlement Institute released statistics in April 2005, indicating life settlements have paid life insurance policy owners an aggregate of more than $1 billion over cash surrender for their policies.

Larry Simon is director, CEO, and president of Life Settlement Solutions Inc., based in San Diego. Life Settlement Solutions and its management have purchased life insurance policies in excess of $1 billion aggregate face value to date. For more information, call 858/576-8067 or visit www.lss-corp.com.