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THE WEEK IN LIFE & HEALTH

FOCUS LIFE SETTLEMENTS

Helping Your Clients Sell Unneeded Policies

The first thing advisors must do is learn how the market works

BY LARRY SIMON

THE MAJORITY OF LIFE INSURANCE policyholders let their policies lapse or surrender the policies for a minimal cash value.

The wealth lost as a result of these policy surrenders is significant. The National Association of Insurance Commissioners, Kansas City, Mo., estimates that in 1996, for example, nearly $1.5 trillion in life insurance face amount lapsed or was canceled by policyholders.

Today, the life settlement market is giving financial advisors the means to help policy owners extract the wealth trapped in unneeded life insurance policies.

How can financial advisors use the tool?

First, obviously, advisors have to learn how the market works. Then they have to learn how to bring suitable candidates for life settlements together with reputable settlement providers.

Larry Simon is president of Life Settlement Solutions Inc., San Diego, Calif., a life settlement funding company.

DUE DILIGENCE

Picking the Right Life Settlement Provider

- **Look for proven industry experience.** A good company should have purchased a total of at least $500 million in face value to date.
- **Confirm that the company is** institutionally funded and will not re-sell the contract to an individual investor.
- **Check with the state attorney general's office** and state insurance department for any complaints or legal action against the settlement provider.
- **Insist on a settlement provider** that uses reputable, independent financial institutions to hold the money in escrow until the change of ownership closes.
- **Prefer settlement providers** that have solid Scope Group ratings.

HOW LIFE SETTLEMENTS WORK

Life settlements are not viaticals.

Unlike viaticals, life settlements (also known as "senior settlements" or "high-net-worth transactions") are based on the proposition that some insured individuals no longer want, need or can afford their coverage.

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 create another option for maximizing the cash value for the policy owner. Consequently, life settlements quickly have developed into a viable and attractive alternative product. The market opportunity exists primarily because life insurance companies typically pay low surrender values when a policy owner decides to redeem or cash in a policy. The surrender values are usually so low that a qualified life settlement provider company can pay a higher value.

Life settlements differ significantly from viaticals in terms of insured eligibility and also in terms of policy characteristics.

A typical viatical settlement is classified as one where the insured is terminally ill or suffers from a catastrophic condition and has a life expectancy of less than 2 years.

In contrast, the insured involved in a life settlement might be in moderate health or good health, with a life expectancy greater than 2 years.

The face value of policies sold through a life settlement tends to be larger, and the policy must have been issued at least 2 years before the life settlement transaction takes place.

In most cases, the policy owner has no continuing obligations after the sale of the policy. The life settlement provider, or a trustee to whom the policy may be retransferred, takes care of future premium payments to make sure the policy is kept current and in-force through maturity.

The life settlement provider arranges to monitor the insured's health status on an ongoing basis by periodically contacting someone designated by the insured for this purpose. Usually, these contacts take place about once every 3 months, depending on the life expectancy of the insured. This process is explained in detail in disclosures given to the insured at the time of the life settlement transaction.

▸OPPORTUNITY FOR AGENTS

For many clients, financial and estate planning needs and the role played by life insurance in financial planning change over time.

Once a policyholder recognizes that a life policy no longer fits current or future needs, the agent can provide a valuable service in facilitating the client's ability to convert a life policy into cash.

Clients could use the cash obtained through life settlements to pay for fixed or variable annuities, long term care insurance, stocks, bonds, mutual funds or other products better suited to their current financial planning goals. In some cases, clients might be able to buy a new individual life insurance policy, a survivorship policy or another policy that fits in better with the client's changed situation.

These commissionable benefits enable agents to provide for the best interests of the client and offer as many financial options as possible. Clients tap into wealth they may not have realized was there by liquefying an otherwise dormant asset. Agents get to reconnect with segments of their books of business, providing a valuable service to the clients, while also ensuring renewals will continue through maturity on the policies sold to the settlement company.

▸IDENTIFYING SETTLEMENT CANDIDATES

Of course, life settlements aren't for everyone.

A good candidate typically has $500,000 or more in universal life coverage, though virtually any type of life insurance, as well as policies held in irrevocable life insurance trusts, could qualify.

Life settlements are designed for people who are not suffering from a life-threatening or catastrophic illness

Life settlements are designed for people who are not suffering from a life-threatening or catastrophic illness and whose life expectancy is about 2 to 10 years. The policy must have been issued 2 or more years ago, generally by an A-rated U.S. insurance company.

The reasons a life settlement solution might work for a client are varied. Perhaps policy owners have accumulated enough wealth that they are essentially self-insured. In other cases, the policy premiums may have become too expensive and unaffordable, and the client would like to seek other coverage. Other scenarios might include a policy owner choosing to remove a policy from a taxable estate or replacing a single-life policy with a joint-and-survivor policy.

▸FINDING GOOD SETTLEMENT COMPANIES

Life settlement brokers and agents should understand both the life settlement market and the players with whom their clients will enter agreements.

Now, advisors can consider life settlement company ratings.

The Scope Group, Berlin, a German rating agency, has started rating life settlement companies for German institutional investors. Advisors should seek settlement providers with high Scope Group ratings.

But advisors should still take a thorough, systematic approach to doing their own due diligence, to protect themselves and their clients.

Advisors should look for experienced companies with good reputations and with managers who have extensive life settlement experience.

Finally, advisors should make sure clients get expert advice about the effects of any life settlement transactions on taxes. NU