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Selling a policy for profit

Life settlements offer a way to get a higher return from no-longer-needed insurance

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Imagine if the only place to sell your used car was to the dealer who sold it to you in the first place.

Until recently, that's exactly what happened in the insurance industry.

"For years, your only potential buyer if you sold your policy was your provider," said **Darin Duin**, a financial adviser who brokers life settlements for Tagge Rutherford in Omaha.

Now individuals — depending on their age, health and policy's death benefit — can sell life insurance and other insurance policies to third parties. The individuals potentially could get more money than they would get from their insurance provider.

The deals, known as life settlements or senior settlements, are versions of the "viatical settlements" that arose in the 1980s, when investors speculated on policies owned by terminally ill AIDS and cancer patients.

With life settlements, investors buy life insurance policies at a discount and collect when the policyholder dies. Policyholders can benefit from such deals if they no longer want to pay premiums to maintain their policies or need to tap a policy's cash value.

Policyholders get more money — sometimes three or four times as much — than they would if they simply surrendered the policies for cash to the insurance companies that issued them.

The deals usually involve individuals age 65 or older with life expectancies of two years to 15 years. Most of the policies sought by investors have death benefits of $250,000 or more, although deals for smaller policies are becoming more common.

Most life-settlement purchases are of universal life policies, although business owners sometimes sell policies they have taken out on key executives.

Such settlements are attractive only to those people holding policies they no longer want, said J.J. Boyle, principal at Selective Settlements in Omaha.

For example, if a husband bought a $1 insurance million policy on himself to provide income for his wife in the event of his death, but then his wife died, the husband may no longer want to pay the policy's premiums. If he surrendered the policy to the insurer, he would receive the policy's cash value, but he probably could get more through a life settlement.

Financial adviser Bob Nelson said one of his clients used a settlement to pay debts from a private business that otherwise might have resulted in bankruptcy. Nelson is vice president of Grace Meyer Insurance Agency Inc. in Omaha.

The client, whose name and business Nelson couldn't disclose because of confidentiality requirements, held a policy with a death benefit worth $1 million. However, he had paid only a fraction of that amount into the policy. Surrendering it would not have raised enough money to cover his bills, Nelson said.

"He sold it for $350,000 — more than the cash value — paid off all his debt, put money in the bank and maintained (another) policy that protected his wife. It changed his life dramatically," Nelson said.

But such stories are not universal, said Tim Wagner, director of the Nebraska Department of Insurance. Although Wagner said he has not received any reports of scams, he cautioned that the market for such settlements is relatively new and may not always yield the best price for a policy.

"There's not a lot of competition for your asset," he said. "You can't go to four or five different places and say, 'What will you pay me?'"

Settlements also can be costly. Most brokers earn a significant percentage — usually in the low double digits — of any settlement the client receives.

Policies usually sell according to a sort of auction system in which a broker shops a policy around to see what investors will bid.

Duin, the broker, said he sees wide variations in what life settlement investors will pay. Brokers often spend up to six months trying to get investors to increase their bids for a policy, he said.

"I've seen one (investor) offer $200,000, and I can see some people go up to $500,000 or $600,000," he said. "There can be that much disparity."

That's why advisers tell clients to pursue life settlements only if they intend to surrender a policy they no longer need.

The life settlement industry has grown slowly, with few major insurance providers entering the market, said Steven Weisbart, an economist with the Insurance Information Institute.

In part, that is because the industry has struggled to gain legitimacy despite more lawyers and advisers promoting the settlements and many states, including Nebraska, regulating them.

Many businesses do not want their name associated with deals that some still think tainted.

"(Viatical settlements) came out of the AIDS epidemics," financial adviser Nelson explained. "People with HIV needed money while they were alive. To get it, they sold their life insurance policies that were certain to pay off."

Furthermore, some of those deals defrauded investors or used predatory tactics to persuade terminally ill patients to acquire policies, Nelson said. Oftentimes, individual investors had an interest in the timing of a person's death.

But industry players have attempted to burnish the settlement's reputation in the last decade as private equity investors and hedge funds have depersonalized the business by bringing billions of dollars to the table.

Larry Simon, president of Life Settlement Solutions in San Diego, said companies such as his will purchase about $12 billion worth of death benefits this year at a cost of about $4 billion.

The volume of settlements is "negligible" compared with the $16 trillion U.S. insurance market, but it has room to grow, Simon said.

"In the next year or two you'll see insurance companies come to companies like ours and try to buy us out."

Some in the industry think the deals increase the cost of insurance because insurance providers write their policies assuming some policyholders will let policies lapse, Simon said.

Keep in mind

Life settlements let you sell life insurance policies to third parties for more than your provider will pay.

You're most likely to get a settlement if you are 65 or older and have a policy with a death benefit of $250,000 or more.

Settlements should be used only for insurance policies you no longer need.