

# Life Settlements: The Multi-Purpose Planning Tool

*From restructuring life insurance to business insurance to split-dollar and more.*

By Larry Simon



**F**or financial professionals working with life settlements, considering more advanced financial planning strategies can help expand your business while benefiting eligible clients.

Many financial professionals are already aware of life settlements and may have already been successful in carrying out the life-settlement transaction process. But they may not have considered how life settlements can apply to some of the more advanced strategies that were utilized with business, estate-planning and other advanced planning strategies. The growth of the market has also created additional opportunities for seniors facing a number of financial situations that could be supported or solved by the revenue generated by conducting a life settlement. Because of this, financial professionals should consider the

following situations and case studies, and begin to view them as another way to further fulfill fiduciary responsibilities to clients while increasing services available to meet the needs of new and existing clientele.



## Term Conversions

Term policies are often thought to have no cash or settlement value. However, in the life settlement marketplace term policies with conversion capability can be evaluated based on the value of the converted permanent policy and can frequently become viable settlement cases. Seniors in this situation can choose to convert their term policy to a universal life (UL) and settle the converted UL policy in the settlement marketplace. To accomplish this, advisors compile

information on the post-converted policy and submit the information to settlement providers for evaluation who then issue pricing offers based on that converted policy. Should the client accept the offer, the term policy is usually converted during the closing process and the client receives proceeds based on the settlement value of the converted permanent insurance policy.

This option allows the insured to access the settlement market using his or her current term life insurance policy and using the proceeds for a variety of purposes including newer more appropriate permanent life insurance coverage. Combining term conversions and the life-settlement

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marketplace can also benefit financial professionals, as conducting such a transaction can result in increased revenues generated for the advisor's business including compensation on the life-settlement transaction, the conversion based on target premium and the purchase of new life insurance.

It is important for advisors to verify that their client can obtain new insurance coverage before transacting a life settlement. If the client's health has deteriorated and the client cannot obtain new insurance or the premiums would be cost-prohibitive, then the term conversion (without a life settlement) might be the only viable option for that client to obtain permanent coverage.

### Term Conversion Case Study

A 78-year-old client has a \$1.5 million 15-year level term policy with two years left on the conversion option (to UL) and no cash-surrender value. The client has an upcoming annual premium of \$10,000 and no longer needs the policy. The client receives an offer of \$220,000 for the post-conversion UL policy, which is accepted. The client converts the policy and completes the life settlement transaction receiving \$220,000 while the financial professional earns \$30,000 upon expiration of the rescission period.



### Restructuring Life Insurance

Financial professionals know clients' insurance needs change over time due to a number of factors. Policies do not always perform as well as expected, which may leave seniors with escalating premiums to surrender or let policies lapse, often for low cash payouts. Financial professionals working with clients in this situation can offer life settlements as a way to get rid of underperforming life insurance and use the proceeds to purchase more appropriate coverage for their current needs.

### Restructuring Life Insurance Case Study

As an example, let's look at a client who has a \$5 million UL policy with premiums that have doubled in recent years. Current cash-surrender value on the policy is \$242,000, but the client decides to consider a life settlement, resulting in an offer of \$1.1 million. The client chooses to sell the policy and use the money from the settlement to purchase a \$2 million life insurance policy to fund a reduced estate tax liability.



### Business Insurance

Life settlements can greatly benefit those dealing with business life insurance, as business owners and executives can use the financial transactions as a way to deal with policies that are no longer necessary due to a variety of reasons including:

- ❖ **Retirement of a key executive, leaving a business with unnecessary key person policies**
- ❖ **Dissolved partnerships**
- ❖ **Executive policy as part of a retirement package, where the retiree has no desire to keep the policy**
- ❖ **Change of business ownership**
- ❖ **Exit strategy for benefit programs and split-dollar arrangements**
- ❖ **Proper asset valuation of business-owned life insurance when calculating the value of a business for appraisal or sale purposes.**

Advisors can incorporate life settlements into their business insurance practice and offer valuable services and advice to business clients. By properly advising business insurance clients on the availability and requirements of the life settlement market, business owners can take steps to effectively position themselves with key executives to access the secondary market by incorporating the potential future sale of a business insurance policy into their corporate policies and executive employment agreements.

### Business Insurance Case Study

As another example, a key executive retires from a company with a \$4 million (face value) corporate-owned life insurance contract as part of a retirement package that has a \$200,000 premium

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and a cash-surrender value of \$646,000. The executive does not want to pay the premiums and is considering surrendering the policy since he feels the cash-surrender value is a sizable sum. After being advised by his agent about the life settlement market, the insured decides to conduct a life settlement resulting in an offer of \$1.25 million.



### Charitable Giving

Many senior clients have strong affinities with charitable organizations and long histories of involvement with charities. But many may desire to donate more than their current available cash. Many seniors are continuing to fund life insurance policies that they no longer need. However, many seniors don't want to donate their policies to charities and leave their favorite charity with

ongoing premiums and administrative obligations. Life settlements can solve this problem by allowing clients to use the proceeds from a life settlement to make a cash donation and alleviate themselves and the charities from any ongoing premium funding, gifting or administrative requirements. This option also allows clients to see that their gifts make a difference during their lifetime, as the charitable organization will be able to use the funds from the life settlement immediately.

### Charitable Giving Case Study

An 85-year-old client wishes to donate to his favorite charity and is considering establishing a trust, but wants to be able to see his gift used while he is still living. In addition, he knows the organization is in need of immediate funding and would not be able to meet the ongoing premiums

associated with the policy. Instead of donating the policy directly, the insured decides to conduct a life settlement and give the charity the resulting proceeds. The transaction benefits the company by providing immediate funding, while also benefiting the insured, as he receives a charitable tax deduction equal to the asset's fair market value to offset the gain from the life settlement transaction.



### Split-Dollar Exit Strategy

Life settlements can also be used to assist executives as an exit strategy for existing split-dollar arrangements. A typical situation is when an executive is the insured on multiple policies, owned by multiple trusts where the company is owed money for split-dollar advances. The client wishes to terminate the split-

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dollar arrangements, eliminate ongoing premium payments, repay the company for the advances, acquire additional life insurance at little or no net cost and profit from the sale of existing policies.

### Split-Dollar Exit Strategy Case Study

To create the original split-dollar arrangement, an irrevocable trust and limited liability company (LLC) structure are formed, where the trust borrows funds from the bank to contribute to the LLC. Once funded, the LLC purchases an immediate annuity. The single payment immediate annuity (SPIA) finances loan interest, life premiums on a new policy, taxes and a cash reserve.

To exit the split-dollar arrangement, the existing life insurance policies are then sold into the secondary market and settlement proceeds are used to repay the executive's employer for

the split-dollar advances and end the split-dollar agreements. The remaining balance is then added to the cash reserve. The SPIA continues to finance premiums on the new insurance policy and loan interest for the bank loan, but the client no longer funds premiums to the trusts for the policies transacted in the settlement market. Ultimately, the death benefit of the new insurance repays the bank loan. Overall, additional "net" insurance is obtained by the client, the split-dollar arrangement is terminated and the employer is repaid for split-dollar advances by settlement proceeds and an increased cash reserve is created.

Life settlements offer professionals a number of ways to assist clients who are facing a variety of financial situations. By considering more advanced strategies, financial professionals will not only be able to help clients, but also grow their

own businesses and increase revenue. Those who are interested in finding out more about the financial planning options associated with life settlements can visit industry organization Web sites, such as the Life Insurance Settlement Association ([www.thevoiceoftheindustry.com](http://www.thevoiceoftheindustry.com)), as well as view applicable presentations from the 2008 Life Settlement Awareness Month Presentations available online at [www.lifesettlementawarenessmonth.com](http://www.lifesettlementawarenessmonth.com). **INN**

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