Sell Your Life Policy to Boost Your Income

LAST YEAR, Wally Jones, 75, lost much of his life savings after selling off a failing business. In search of retirement income, the Jacksonville, Fla., resident looked no further than the insurance policy that his wife, Donna, 66, owned on his life. She sold the $1.5-million term policy to an investor, who gave her $187,500 in cash. "I wish I had known about this option sooner," says Jones. "I had several policies that I let lapse because I didn't know they had any value."

Of course, the investor will profit big-time when Jones dies, but that disquieting prospect is not stopping thousands of seniors from looking to a relatively new option known as a life settlement. This practice allows individuals to cash in on the value of their life insurance when they no longer need it or can no longer afford the premiums. An investor buys your policy for part of the face value, continues to pay the premiums and collects the benefit when you're gone.

The amount you get depends on several factors, including your age, the face value of the insurance policy and the amount of the premium that investors will have to pay to keep the policy in force, says Norman Hood, an independent insurance broker in Rushville, Ill. Policyholders and professional advisers can get an estimate of the potential value of a life settlement using the LIVEpdq calculator at Hood's Web site (**www.policysettlement.com**).

Most types of life-insurance policies, including universal-life, whole-life and corporate-owned policies, are eligible for life settlements. Term life-insurance policies must be convertible to qualify, meaning they can be changed to universal-life or whole-life policies without proving good health. Hood says most term policies are convertible to age 65.

An Emerging Industry

Life settlements are an offshoot of viatical settlements, first developed in the 1980s to buy life-insurance policies from terminally ill AIDS patients. But as new drugs extended the lives of those patients, investors who were betting on the patients' early demise saw their profits disappear. Unlike viaticals, life settlements involve policyholders with longer life expectancies, usually of up to 12 years. Most candidates are at least 65 years old, although some younger individuals could qualify if they have shortened life expectancies because of health conditions.

Also, while viatical settlements linked individual investors with terminally ill policyholders, institutional investors have been driving the growth of life settlements. These large investors are looking for higher returns than those available from fixed-interest instruments or bond markets.

The life-settlement business, which has grown to $13 billion since the mid 1990s, is expected to increase tenfold over the next several years, according to Sanford C. Bernstein & Co. It notes that the target market for life settlements—individuals age 65 and older—will nearly double over the next 25 years.

"Financial planners and other investment advisers have an obligation to let their clients know there is now a way to unlock the value of life-insurance policies," says Larry Simon, chief executive officer of Life Settlement Solutions, a California firm that represents institutional investors.

Tax Consequences

Although life-insurance benefits are tax-free, money obtained through a life settlement is not. Any money in excess of premiums paid is subject to tax. Let's say you paid $50,000 in premiums over the years for a whole-life policy that had a cash surrender value of $60,000, and you accepted a life settlement worth $200,000. The initial $50,000, representing premiums paid, would be tax-free. The next $10,000 (the difference between the surrender value and the total premiums paid) would be taxed as ordinary income. The remaining $140,000 would be taxed at the maximum capital-gains rate of 15%.