

MARCH 2008

www.lifeinsuranceselling.com

LIFE INSURANCE SELLING

Magazine for Top Life, Health, and Financial Services Professionals

Selling to the Charitable Impulse

An Insider's View of a Growing Practice

The 'Extreme Makeover' of Annuity Agents

Using Life Settlements for Charitable Giving



By Larry Simon

Life Settlement Solutions, Inc. • San Diego

Financial professionals working with affluent seniors, who are looking to make charitable donations, can offer such clients the option of using life settlements to reach philanthropic goals.

Life insurance has long held an important role in charitable gifting strategies, and continues to do so. In recent years, life settlements have emerged as a powerful tool in charitable gifting strategies as well. In fact, since their emergence in the insurance market in the early '90s, life settlements are providing seniors new options for dealing with unwanted life insurance policies.

In the past, seniors who needed new insurance coverage or no longer needed their existing policies had few options: either surrender their policy for often low cash surrender values, or allow their policy to lapse. Seniors today have the ability to use life settlements as a means of accessing funds that may have been lost if a policy had been surrendered. Additionally, high-net-worth seniors looking to donate to

charity can use the money garnered from a life settlement transaction to fund a charitable gift without dipping into other life savings.

“ ... high-net-worth seniors looking to donate to charity can use the money garnered from a life settlement transaction to fund a charitable gift ... ”

Life Settlements Re-Cap

Life settlements are financial transactions in which underperforming or unnecessary life insurance policies are sold in the secondary market to a third-party purchaser. Such transactions can result in cash payments that are higher than the cash surrender values of the policy. Once a life settlement is conducted, the client relinquishes all rights to the policy, while the purchaser becomes the new owner. Upon the death of the insured, the purchaser collects the policy's death benefit.

While life settlements have proven beneficial for many senior clients, they are not for everyone. Life settlements are designed

for clients who meet certain age requirements and are free from catastrophic or life-threatening diseases. Requirements vary throughout the industry, but life settlement candidates and their insurance contracts usually meet the following eligibility requirements:

IIR Code: 1600.01 Charitable Estate Planning

- Candidates should have \$250,000 or more in life insurance, typically as universal life coverage;

- The policy should be beyond any carrier or statutory contestability period, subject only to the payment of premiums and fully renewable;

- Term policies are usually eligible if they are convertible or if they have a minimum term life insurance coverage equal to the greater of two times the life expectancy or 10 years; and

- The insured's life expectancy is typically between 25 and 169 months, based on the conclusions of a medical life expectancy provider.

Why Use a Life Settlement to Donate?

Even before life settlements, using life insurance as a deferred gift or as wealth replacement for assets used to fund a charitable gift was not uncommon. Many seniors who used this option were looking to donate their policies to help benefit philanthropic organizations, but instead left such charities with ongoing and overwhelming responsibilities. Many charities that received gifts in this way were forced to dedicate needed resources to the administrative requirements of trusts, carrier paperwork, and gift accounting, while also dealing with escalating premiums on some policies. In addition, organizations often had to wait long periods of time for policy benefits to become accessible.

Because of these issues, both donors and charitable organizations chose to surrender policies and use the cash surrender amount to fund the donation. While this option reduced problems with insurance policy donations, it also caused charities to unintentionally lose significant amounts of money, which could have been collected if the policy had been sold into the secondary market. Using life settlements to fund donations gives seniors the ability to achieve their gifting goals without leaving their favorite charity with expensive and time-consuming issues. Using this option also provides financial professionals a means of working directly with benefactors in order to ensure the maximum fair-market value for their clients' policies.

Charitable Organizations Still Need Support

In past years, charitable organizations have continued to look for sup-

port, and according to Giving USA 2007, a yearbook on philanthropic activities published by the Giving USA Foundation, overall giving has increased. Some organizations have seen an upsurge in donations following natural disasters, while others have noticed a rise in funding to charities focused on the arts and culture. While gifting may be up in some areas, there are always charities looking for support. For clients who want to give, but do not have the funds handy, conducting a life settlement can help with affording the donation, while also allowing seniors to see their gifts make a difference during their lifetime. For charitable organizations, life settlements offer an innovative resource and strategy for donors to tap funds that they may not have realized were available.

Gifting With Life Settlements — When Is It Appropriate?

For seniors looking to give, there are some situations when donating a life insurance policy directly to a charity proves effective. For most situations, including when the benefactor and charity are unable or unwilling to meet the continuous administrative and premium obligations associated with the policy, a life settlement could be a more beneficial way to donate. By settling an insurance policy in the secondary market, clients are able to obtain increased funds, which can then be donated directly to the charity, cutting down on any additional funding requirements.

The following case studies demonstrate situations in which using a life settlement to fund a charitable donation could help benefit the client and the organization. Please note that these are examples and should not be used to estimate the value of any other potential life settlement transaction.

Case Study One: An 85-year-old client has a \$1.75 million universal life policy that he purchased 10 years ago. Following a number of financial changes, the policy no longer meets the client's needs. After analysis, it is determined the cash-surrender amount on the policy is \$140,700. The client decides to be evaluated for a life settle-

ment and learns that he can sell his policy in the secondary market for \$670,000, which is \$529,300 more than the cash value on the policy. In addition to no longer needing the policy, the client has always been interested in

• • • • •
“By settling an insurance policy in the secondary market, clients are able to obtain increased funds, which can then be donated directly to the charity, cutting down on any additional funding requirements.”
• • • • •

charitable giving, but has never had the out-of-pocket funds to do so. By conducting a life settlement, the client will have access to a significant amount of money, that can be donated to charity. In this situation, conducting a life settlement may be an appropriate option, as the client can now donate without using his life savings.

Case Study Two: The client is an 83-year-old woman who owns a \$5 million universal life insurance policy that was purchased eight years ago. After an analysis of the client's financial status, it is determined that she no longer needs her insurance policy due to the fact that her expected tax liability has declined substantially. Also, premiums on her policy have escalated because of policy underperformance. After evaluation, she is told the cash surrender value of the policy is \$37,100, but that if she sold the policy in the secondary market, she would receive a payment of \$302,000. The client no longer needs the policy coverage and would like to donate to a charitable organization. After contacting the charity, the client learns that the organization is unable to take on the administrative obligations and premium payments required on a donated policy. In this case, a life settlement transaction may be appropriate, allowing the charity to receive a direct donation.

Life Settlement Funded Donations and Tax Benefits

If a client deems that the settlement transaction is appropriate and wishes to use a portion or all of the settlement money to fund a charitable donation, he or she can benefit from

the resulting income-tax deduction. High-net-worth seniors who decide to donate usually receive an income-tax deduction that equals the asset's fair-market value, to minimize or eliminate the taxable gain from the appreciated value of the life insurance asset. Clients who are considering life settlements can donate the proceeds acquired from the transaction to receive a charitable deduction, which equals the policy's higher market value. This may be a better option for some, as donating directly to a charity may result in a charitable deduction equivalent to the lower-cost basis in the asset (premiums paid).

Life settlements may produce taxable gains and potential taxable ordinary income. While federal and state tax laws differ and the IRS can issue new rulings, the proceeds from any sale of a life insurance policy often fall into three tax treatment categories:

1. Ordinary income — Income that is generated if the policy has a cash surrender value that is larger than the cost basis (same as if the policy were cash surrendered). The difference between the cash surrender value and cost basis is typically treated as ordi-

nary income.

2. Long-term capital gains — If the policy has been held for more than one year, any settlement proceeds exceeding the surrender value are treated as long-term capital gains.

3. Return of capital (up to cost basis) generates no tax liability — Settlement proceeds up to the amount of the owner's cost basis in the policy (sum of premiums paid by the policyholder), result in no tax liability. This is because such proceeds are a return of capital.

For clients who are interested in donating via a life settlement, it is important to consider the potential tax liability generated from such transactions. Financial professionals should work with clients and their tax advisor to evaluate whether to transact a life settlement and donate the proceeds or to donate the policy to a charity and have the organization transact a life settlement. When donating proceeds of a life settlement to charity, it is always a good idea to have a qualified and experienced tax professional assess each client's situation.

Learn More Now

Financial professionals who would like to find out more about life settlements and the opportunities they can provide to senior clients can visit the Web sites of such industry groups as the National Association of Insurance Commissioners (NAIC), National Conference of Insurance Legislators (NCOIL), and the Life Insurance Settlement Association (LISA), as well as the site for Life Settlement Awareness Month. With the right information, financial professionals will be able to fulfill their professional responsibilities to clients by offering seniors more efficient options for donating.



Larry Simon is director, chief executive officer, and president of Life Settlement Solutions, Inc. Mr. Simon carries out long-range strategic planning and development, builds relationships with funding sources and brokers, and has executive oversight of the general business affairs of the company.