WHY LIFE SETTLEMENTS?

Managing and insuring risk is no longer an option … it is a necessity for financial survival, and this includes protecting estates and retirement funding. Life insurance, specifically, is an increasingly important risk-management tool for seniors to utilize. Results of a recent survey showed that 60-70% of seniors do own life insurance, but only 50% have some knowledge of life settlements. Life insurance sales to seniors age 55 and older are up as reported by NAIC and ACLI, and numerous reports indicate that seniors plan to delay retirement for 2 – 5 years. Baby boomers and seniors are taking action, I believe, in response to dwindling pension and retirement assets. They are purchasing life insurance with several strategies in mind: a) policies pay 3-4% earnings which is greater than money markets and U.S. Treasuries and have less risk than stocks, and insurers are still perceived as financially secure even though there is some concern regarding reserves among experts; b) the life insurance policy provides survivor security in the event of death prior to restoring sufficient retirement/survivor funding; and c) once such funding is restored, the policy may be sellable in the Life Insurance Secondary Market (LISM).

A life settlement is the sale of an unneeded/unwanted life insurance policy to a third party buyer, typically a large financial institution. The net settlement price to the seller should be greater than the policy's cash surrender value but less than its net survivor death benefit. The purchase amount is paid upon completion of the sale. Ownership of the life insurance policy transfers to the buyer, who continues to pay the policy premiums. The policy survivor benefits are paid to the buyer upon the insured's death. Agent and broker fees range from 5% to 30% of the gross transaction amount. Life settlements are best suited to:

- Policy owners aged 65 or older, with life expectancies of two to twenty years; and,
- Life insurance policies at least two years old (past contestability), with a face value of $250,000 or more (a few buyers will go down to $50,000).

Before advising your client to pursue a life settlement, determine if some level of life insurance should be maintained. Will debts or obligations need to be settled from the estate and not left as a burden upon survivors? May a surviving spouse or dependants need funding for living and/or care? Is the estate large and mostly illiquid, requiring funds to pay estate taxes? Or, does the policy owner desire to create tax-free money for children or other beneficiaries, and can easily afford the insurance?

Your client *should* consider a life settlement, however, if any of the following are true:

- Estate planning needs have lessened.
- Life insurance that was required for business reasons is no longer needed.
- Insurance premiums are curtailing care of basic living needs.
- Social security dollars are being used to pay premiums.
- There is a preference to use the premium money for travel, cultural involvement, socializing, hobbies, or other activities that provide wholeness of life in retirement.
- More profitable savings and investment opportunities are available.
- Retirement funding is sufficient to support a spouse following death.
- Retirement funds have been materially depleted and alternative funding is needed.
- Better life insurance can be purchased for less cost.

What are the benefits of a life settlement for your client? Premium payments are eliminated. Cash received is greater than the surrender value. There are no limitations on the use of the sale proceeds, for example it can be used to purchase different life insurance or annuity products; for supplement retirement funding; to buy long-term care insurance and/or pay health care costs; pay off debts; enjoy more travel; purchase a new car; pay college tuition for a grandchild; make charitable contributions; or anything that might desired. Life settlements are not only for someone who is terminally ill. Today, many life settlements involve seniors with normal, or even longer than normal, life expectancies.

How might a life settlement be bad for your client? At some later time, if your client discovers a need for more life insurance, they may find that they can no longer get it. Family beneficiaries may feel that they have been cheated. All of your client's medical and much of their personal information will be available to others, even though such information is required to be kept confidential. And, there are many documents and agreements to understand and sign, possibly including some for the spouse and beneficiaries. Finally, the process can require two to three months to close.

Are life settlements legal? Yes, life settlements are legal in the United States. A U.S. Supreme Court decision in 1911 (GRIGSBY v. RUSSELL, 222 U.S. 149) determined that a life insurance policy is private property that can be sold at the will of the owner, and the buyer is not required to have an "insurable interest" in the insured. Currently, thirty states have life settlement laws, most of which require agents handling a life settlement transaction to be licensed.

It is important to understand that a new life insurance policy cannot be issued subject to an agreement to sell the policy after the two year contestability or five year holding period. This situation is termed a "Stranger Originated Life Insurance Policy," (STOLI), and is illegal in most states.

Life settlements continue to be a strong liquidity resource for seniors, but unfortunately, capital available to purchase policies remains limited. This is not a reflection of life settlements, but a lingering result of capital markets staying on the sidelines until economic factors return confidence. Life settlement prices are down compared to 2007 and 2008. This is a result of both capital scarcity and increased mortality longevity. People are living longer as is reflected in updated mortality tables released in 2008. Thus prices have drifted down in order to provide the investment yields required by investors, but prices are still attractive to sellers and fees remain attractive to agents.