

LIFE SETTLEMENTS

What you Need to Know as a
Trusted Advisor



This informational booklet is dedicated to all professionals who work with affluent seniors, including:

Financial Planners
Trust Officers and Trustees
CPAs
Estate Planners
Attorneys
Life Insurance Consultants and Agents
Foundation and Charity

We hope you find the information relevant and useful when determining if a Life Settlement is a viable option for your client(s),



Today, there are approximately 36 million individuals in the United States over the age of 65. By 2030, there will be 72 million.

- U.S. Census Bureau

The birth of a promising new senior market

For more than a century, the life insurance industry has held a monopsony over the consumer, all but assuring that the policyholder can sell to only one buyer—the same company that issued the policy. Because of this one-sided market, the policyholder had no other option but to settle for a low cash surrender payout from the insurance carrier.

This inefficiency in insurer-paid cash surrender values led to the development and growth of the secondary market for life insurance. The market was initially spawned in the 1990s by the viatical settlement industry which created a secondary market for terminally ill policyholders who needed life insurance benefits prior to death to pay for the costs of care. Due to growing effectiveness of drugs and medical care and the increased lifespan of terminal patients, the viatical industry was no longer the viable market it once was and the prospect of a secondary market for seniors who wished to sell their obsolete or underperforming policies was born.

With the advent of the life settlement market, policyholders can now access fair market value for their policies, rather than accepting the lower cash surrender value from the issuing life insurance company. Subsequently, the market gives seniors and their **trusted advisors** access to a wide range of institutional buyers and the opportunity to receive a much higher payout than the cash surrender value paid by the insurance carrier.

Industry sources estimate that the life settlement market has grown from \$0 in the mid-1990s to around \$16 billion today and is expected to grow more than ten-fold to \$160 billion over the next several years. The settlement market has grown about eight times faster than non-traditional life insurance.

By allowing companies to compete for unwanted or unneeded policies, the secondary market has generated greater consumer choice, a wider range of insurance products and favorable valuations for consumers.

Selling one's life insurance policy as part of a broader financial plan may be a prudent business decision, but nonetheless a significant step for the policyholder. The individual will want to know that they can rely on their trusted advisor to recommend the best course of action to meet their changing needs.

This informational booklet will help answer many of the questions that advisors have about life settlements and how this exciting new market and financial tool can be a benefit and opportunity for themselves and their clients.

Ten Things You Never Thought You'd Live to See

10. A computer can now hold the entire contents of the Library of Congress
9. An implanted, artificial heart can extend life expectancy five years or more
8. Eating chocolate is actually good for you
7. Living in outer space for three months and more.
6. People don't use their phones for just talking anymore
5. Meeting and dating people on your computer
4. The 4 minute mile is the standard rather than the exception
3. 40,000 songs in the palm of your hand
2. You don't need a physical location for your office anymore
1. Selling your unwanted or unneeded life insurance policy for more than the cash surrender value

What is a life settlement?

A senior life settlement is the sale of an unwanted, underperforming or obsolete life insurance contract by an elderly individual to a third party for an amount less than the face value, but in excess of the cash surrender value.

Life settlements were created out of the need for seniors to attain access to the death benefit while still living. With a life settlement, the insured has a medically determined life expectancy of three to seventeen years.

Life settlements should not be confused with viatical settlements, in which life insurance policies are purchased which cover the lives of persons with terminal illnesses—usually with life expectancies of thirty-six (36) months or less.

Until the advent of the life settlement market, a cash surrender or lapse were the only choices available to consumers. Basically, a cash surrender is the sale of a life policy back to the insurance company before it matures for cash value. This transaction doesn't take into effect the current health of the policyholder and, if determined, the insured's health has declined since the policy was issued, the policy may be worth a considerable amount more than the surrender value.

Over **80%** of Universal Life policies never result in a death claim. They are either surrendered, or worse, allowed to lapse.

- Milliman, 2005



Who is an ideal life settlement candidate?

Typically, seniors with multiple or underperforming life insurance policies are great candidates for life settlements. General guidelines are seniors age 65 and older who have:

- Substantial net worth
- Life expectancy of 3 years or greater
- A change in insurability since policy issue
- Greater than \$250,000 face value policy
- Life policy is beyond the 2-year contestability period

Please refer to the [Qualifier Form](#) at the end of this booklet to better assess whether a life settlement is a viable option for a prospective candidate.



Case Study: Term Life

Mr. Bates was a 74-year old widower with a \$500,000 term policy and a cash surrender value of \$0. His current annual premiums were \$12,500. Since there was no longer a need for the policy, his advisor suggested that rather than letting it lapse and receive nothing, he explore a life settlement as an alternative.

A life settlement expert was able to solicit multiple bids from a variety of institutional funders around the world. Within two months, a top offer of \$114,500 was made for the policy and accepted by Mr. Chambers. Upon receipt of the payout, Mr. Chambers promptly placed the cash into his grandson's college fund.

What types of policies qualify?

Any of the following types of life insurance qualify as long as the policy has been in force for a minimum of two years:

- Term
- Universal life
- Whole life
- Survivorship
- Adjustable
- Key Man or COLI (Corporate Owned Life Insurance)
- Group life insurance (as long as it is convertible)

Why would you consider a life settlement for your clients?

A life settlement may provide a better alternative than allowing an unneeded policy to lapse or be surrendered for its cash value. Life settlements are considered for a variety of reasons, including:

Personal Purposes:

- To use the proceeds to purchase replacement coverage
- Life insurance policy is no longer needed or not performing as intended
- Financial obligations or unforeseen financial needs
- Gifts to family members or contributions to charity
- Unaffordable premium payments
- Bankruptcy liquidation or Divorce

Estate Planning Purposes:

- Estate taxes no longer an obligation
- Liquefy inactive asset
- Gift or other tax related expenses
- Estate law changes

Business Purposes:

- Buy/sell funding is no longer an obligation
- Payout or change in deferred compensation
- Elimination of the need for the Key Man
- Change in financial needs

Who makes the ongoing premium payments?

The provider that purchases the policy will assume the ongoing premium payments.

Will the insured be required to accept an offer from a provider?

No, clients are not required to accept the offer from the provider.

Will the insured need to take a medical exam?

No, any offers will be based on the medical records obtained from the insured's physician(s). All information is obtained in a HIPAA compliant process and kept completely confidential.

The life settlement process

Assessment of the life insurance policy can be completed in two weeks. Once all the supporting documentation has been gathered, the process takes approximately 2-3 months.

The chart below details the various steps in the life settlement process.

Need is established by advisor or policyholder
Policyholder submits application and provides necessary documentation
Settlement company gathers supporting documentation (illustrations, insurance verification, medical records)
Determine if policy qualifies or does not qualify for a settlement
File sent out to various funding sources for competitive bidding
Settlement company relays best offer to advisor or policyholder
If offer is accepted, a closing package is sent to advisor or policyholder for review and necessary signatures
Signed documents are returned and reviewed. Insurance carrier is notified
Upon written verification of change of ownership, the funds are dispersed to the settler from escrow



Case Study: Whole Life

Ms. Williams' marketing agency was still making high premium payments on her retired partner's \$3.5 million policy. There were loans secured by the policy of \$500,000 with the net death benefit being \$3 million after deducting the loans.

Since the policy was now outdated and the premiums were a liability, she considered cashing in the policy for its cash surrender value of \$850,000. Instead, her company's CPA suggested that she utilize a life settlement expert to sell the policy on the secondary market.

The policy fetched a price of over \$1.3 million on the secondary market, which yielded \$550,000 more than the cash surrender value.

Will the policy qualify if it is owned by someone other than the insured?

Yes, the policy will qualify even if it is owned by any of the following:

- An individual
- A trust
- A corporation
- A charitable organization

How much will your client be paid for his or her policy?

The amount to be paid to the owner of the policy depends upon a number of factors, including:

- Face value of the policy
- Life expectancy of the insured
- Amount of premiums that will have to be paid to keep the policy in force
- Cash surrender value of the policy
- Loans against the policy
- Type of policy
- Rating of the insurance carrier

Who buys life insurance policies?

Many large global financial institutions are currently investing in life insurance policies, some of which are listed below.



Why is institutional funding for life settlements important?

Life settlements provide maximum protection from the fraudulent practices and personal privacy risks that too often plagued the viatical industry. The recent cases involving individual investor fraud have made clear the importance of large investors, which are experienced risk and case managers. Moreover, individuals are ensured greater privacy protection throughout the life of the policy. The influx of institutional sources of capital has expanded the life settlement market. This results in significant benefits to policyholders, life insurers and investors themselves. These sophisticated financial investors, including multinational banks, international corporate conglomerates and global insurance companies, offer policyholders maximum value in a competitive market.

What if the insured dies shortly after selling his or her policy?

If the insured dies at any time up to the 15th day after receiving the cash settlement, the contract will automatically cancel (unless otherwise stated). The provider will pay the original policy owner or beneficiaries any proceeds it receives from the policy (minus any money the provider paid for the purchase of the policy and any life insurance premiums paid to the insurance company to keep the policy in-force).

If a policy is large, does all of it have to be sold?

No. Often the insurance company will allow you to divide the policy into multiple parts, the owner retains one part, and they may sell the other part as long as it has a death benefit of at least \$250,000.

Are there any restrictions as to how proceeds from a life settlement are used?

The selling policyholder is free to use the settlement as he, she or it chooses. Some owners use proceeds to purchase long-term care insurance or a more appropriate and better performing life insurance policy. Others gift the money to family members and charities or fund investments. Still others use the money to enhance the quality of their lives.

What are the tax implications of a life settlement?

As with any tax related issue, a tax professional should be consulted. However, it is generally understood that any amount paid for a policy in excess of the cash surrender value is treated as a capital gain. The cash surrender value in excess of the basis in the policy is treated as ordinary income.

The example below illustrates the possible tax consequences of a life settlement.

Face value of policy: \$1 million

Life settlement offer: \$250,000

Cash surrender value: \$80,000

\$195,000
Taxable as
Capital Gains

\$65,000
Premiums paid
Non-taxable

\$15,000
Taxable as
ordinary income

This example is for illustration purposes only. The tax implications of a life settlement transaction are effected by the details of each specific case. A tax professional should be consulted whenever a life settlement is considered.

Is the buying and selling of existing life insurance policies regulated?

Regulation of life settlements is generally administered through the respective insurance departments of each state. There are currently 39 states with some form of viatical or life settlement regulation featuring principles of the NAIC Model Act. The statutory language and regulatory interpretations vary on a state-by-state basis. The Act was introduced in 1993 by the National Association of Insurance Commissioners to regulate the sale of life insurance policies by a protected class of terminally ill individuals and was expanded in 2001 to regulate all persons selling life insurance policies.

In those states where life settlements are not regulated, members of the life settlement industry are working with state legislators to enact such regulation.



The proceeds from a life settlement are used to fund a more cost-effective life insurance policy.

Case Study: Joint Life Survivorship

Mr. and Mrs. Chambers held a \$1.4 million joint survivorship policy that matured at age 95. The policy was not performing and the premiums were due to increase from \$16,000 per year to \$24,000.

Because of their age (75 and 76, respectively) and other qualifying factors, their life insurance agent realized that a life settlement would be a viable option. Their policy was sold on the secondary market for a total of \$175,000. The proceeds from the sale were used to purchase a new joint life survivorship policy with a lifetime maturity and contractual annual premiums of \$11,000.

In the end, the couple was able to obtain a better, locked-in insurance contract and reduced their premiums by almost \$13,000 per year.

Benefits to the trusted advisor

As a trusted advisor, clients depend on you to help them make informed decisions about their finances and other important assets.

Whether you are a CPA, financial planner, trust officer, estate planner, attorney, life insurance consultant or other trusted advisor, it is becoming more evident that life settlements are an important new planning tool that benefits both the client and the advisor in many ways.

1 in 5 policyholders over 65 is in line for a life settlement greater than the surrender value of the policy.

- Conning & Co.



For financial planners

As a financial professional, you have a fiduciary responsibility to represent your clients' best interests by advising them on all relevant alternatives. You can assist your clients by exploring all the options that exist when they are considering an exit strategy for any life insurance policy.

Financial professionals are quickly recognizing the importance of this new option as seniors now have a competitive and more profitable alternative to policy lapses, cancellations and surrenders. There are clear financial benefits to a life settlement, including:

- Eliminating premiums on obsolete or unaffordable life insurance policies
- Generating more cash than if the policies were surrendered
- Using the funds from a dormant asset to better serve current financial goals
- Providing cash for philanthropic causes, gifts, medical expenses or any other purpose
- Using proceeds to purchase a more efficient, cost-effective life policy

Aside from fulfilling a fiduciary responsibility, the benefit to the advisor is that the proceeds from a life settlement can be used to make additional investments – clearly a win-win situation for all parties involved.

For trust officers and trustees

Although trust owned life insurance (TOLI) is a common planning vehicle for many affluent individuals and families, relatively few TOLI policies ever meet their initial projections. Policy performance can change drastically over time and policies, especially older ones, can pose very significant risk or not achieve their original goals.

Trustees need to recognize that life insurance is an asset that must be periodically reviewed by an independent expert to avoid risk and optimize asset performance. If a life insurance policy is underperforming or is insufficient for current client needs, then a life settlement may be the best option.

For CPAs

The growing life settlement market is a new frontier for CPAs who serve both affluent seniors as well as corporate clients. In addition, many CPAs serve as advisors to charitable organizations that accept donated life insurance policies. Therefore, it is important that CPAs have an understanding of the many benefits of a life settlement.

If you are currently working with senior clients who have unneeded or underperforming life insurance policies, it is very likely that you can save them substantial sums by using the proceeds from a life settlement to purchase a new policy with better coverage—and in some cases cancel the annual premiums entirely.

CPAs also need to understand the value that a life settlement can provide in terms of assisting their senior clients with estate planning decisions that enhance the senior's financial portfolio. In addition to providing an exit strategy from a more expensive policy, life settlements can also provide options to other financial planning objectives such as providing liquidity for other investments, freeing up cash, facilitating charitable giving, financing long term care, and enabling cash gifts to family members.

CPAs will also want to consider a life settlement in certain business applications. In the case of a buyer considering the purchase of another company, part of the due diligence should involve an evaluation of "key man" life insurance policies on departing executives. It is often the case that such policies are permitted to lapse without even being aware of their life settlement qualifications. Furthermore, life settlements can be used to enhance severance or retiree packages.

Advisor tip: Life settlement offers can vary widely. In order to obtain the highest possible valuation for a client's policy, advisors should consider retaining the services of an experienced settlement expert who can solicit multiple offers from many buyers authorized to do business in the state in which the policy ownership resides.

For estate planners and attorneys

The secondary market for life insurance is providing estate planners and attorneys with an additional tool to serve their high net worth clients. As estate planners develop strategies to ensure that assets are transferred in accordance with their clients' wishes, they need to ask themselves if the proceeds from a life settlement will help provide for the more effective distribution of the estate.

As a result of the life settlement market, estate planners and attorneys will want to consider the following:

- When the market value of a client's assets are inventoried, the advisor and client will need to know the fair market value not only of stocks, bonds and real estate, but of life insurance policies as well.
- In advising clients how to exit from any unwanted life policy, advisors need to consider whether a life settlement is the most suitable choice.
- In estimating death taxes, advisors need to consider how the IRS will value any life insurance policies on the lives of others. Will it be at fair market value?

Life insurance consultants and agents

Life insurance consultants and agents are reaping the rewards of life settlement transactions they introduce to their clients. The secondary market for life insurance is not only keeping existing policies in force, but life settlements are producing cash for the purchase of new life insurance policies.

Benefits to the life insurance consultant and agent include:

- Continue earning renewal commissions on the existing policies.
- Earning new commissions on new life insurance policies sold.
- Earning conversion commissions on converted term policies.
- Earning fees for investing the clients funds in annuities or other investments.
- Acting in the best interest of your client by advising him/her about the possibility of selling a life insurance policy for more than cash surrender value or selling a term policy instead of letting it lapse.

Although some life insurers complain that the sale of policies into the secondary market is unfair and hurts profits, the very existence of the secondary market has increased the value of life insurance, which in turn should increase demand for new policies. The entry of insurance carriers into the life settlement market is a strong indication that even insurers acknowledge the opportunity and value of this market.

For foundations and charities

Not-for-profit organizations are learning that life settlements can be another unrealized source of gift-giving. Many organizations already possess gifted life insurance policies or have a donor base of seniors who no longer have a need for their policies. A life settlement can offer many benefits to the organization and the donor, including:

- Receiving a donation from a donor who may not have otherwise been in a position to contribute
- Providing cash that can be used immediately for charitable causes and programs
- Donating to a favorite philanthropic organization without depleting cash reserves or losing income-producing assets
- Getting a tax deduction for the fair market value of the life insurance policy instead of only the cash surrender value
- Helping donors achieve their philanthropic legacy while still living
- Eliminating costly premiums and annual reviews on donated policies
- Providing a valuable option to the donor that furthers their tax and estate planning objectives and creates an opportunity for future gifting



Questions to ask your clients/donors

The following are common questions to ask your clients or donors prior to determining whether a life settlement may be a viable option:

When was the last time you had your policy reviewed?

Do you have a policy that is underperforming?

Does the need for the policy still exist?

Have you had any significant life changing events?

Is your policy in danger of lapsing or being surrendered?

Life Settlement Qualifier Checklist

This form is intended as a tool to quickly assess whether a life settlement is a viable option for a prospective candidate. Ideal candidates for life settlements are high-net worth seniors age 65 and over and have a life insurance policy with a face value of at least \$250,000.

PART I: THE CLIENT

- 1-point Male aged 74 or less or female aged 77 or less
- 2-points Male aged 75 to 78 or female aged 78 to 81
- 3-points Male aged 79 to 83 or female aged 82 to 86
- 4-points Male older than 84 or female older than 87

- 1 point In good health
- 2 points Minor health problems
- 3 points Significant health problems
- 4 points Has a terminal or catastrophic illness

If the total score exceeds three points, please proceed to Part II.

PART II: THE POLICY

- 1-point Whole Life
- 2-points Variable
- 3-points Term or Joint Survivorship
- 4-points Universal or Joint Survivorship with one deceased

- 1 point Cash value exceeds 30% of death benefit
- 2 points Cash value is 20-29% of death benefit
- 3 points Cash value is 10-19% of death benefit
- 4 points Cash value is less than 10% of death benefit

- 1 point Loan value exceeds 30% of death benefit
- 2 points Loan value is 20-29% of death benefit
- 3 points Loan value is 10-19% of death benefit
- 4 points Loan value is less than 10% of death benefit

- 1 point Premiums exceed 4% of death benefit annually
- 2 points Premiums between 3% and 4% of death benefit annually
- 3 points Premiums between 2% and 3% of death benefit annually
- 4 points Premiums less than 2% of the death benefit annually

Total Score: _____

- Less than 10: Requires a score of 5 or greater in Part I to qualify
- 10 to 13: Is a good candidate
- 14 or greater: Is an excellent candidate

Glossary

Cash Surrender Value

Also referred to as “cash value.” This is the amount of money, before adjustment for policy loans or late premiums, that the policyholder will receive if the policyholder allows the policy to lapse or cancels the coverage and surrenders the policy to the insurance company.

Contestability Period

The time period at the beginning of a life insurance policy during which the insurer can challenge the death claim based on material misrepresentations submitted at time of issue.

Death Benefit

Also referred to as the “face amount” or “face value.” This is the dollar amount stated on the specification page of a policy and paid by the insurance company to the beneficiaries of the estate, less any outstanding debts or liens, upon policy maturity or death.

Face Amount

The amount stated as payable at the death of the insured at the maturity of the contract.

Life Expectancy (LE)

The average number of years of life remaining to a number of people of a given age according to a given mortality table.

Life Settlement

The sale of a life insurance policy by the policyholder, before the policy matures. Such a sale, at a price discounted from the face amount of the policy but usually in excess of the premiums paid or current cash surrender value, provides the seller an immediate cash settlement.

Life Settlement Provider

The company that purchases life insurance policies in a life settlement and takes over premium payments and subsequently receives the death benefit.

Net Death Benefit

The death benefit of the life insurance policy or certificate to be settled, less any outstanding debts or liens.

Premium

The amount of money a policyholder pays, usually in installments, for an insurance policy or annuity. Payment plans vary depending on the type of policy or annuity.

SOLI (Stranger Owned Life Insurance)

Transactions in which life insurance policies are sold after policy issuance to third party investors at a premium over the value that would be received upon surrender to the carrier.

About Life Settlement Advisors, LLC

Located in Indianapolis, Life Settlement Advisors, LLC is Indiana's premiere life settlement company. The company is committed to partnering with seniors and the professionals who serve them — providing innovative financial options as their needs and goals change. Through a wide network of funding institutions, the company obtains multiple offers on the secondary market in pursuit of the highest possible settlement for the policyholder.

Leo M. LaGrotte

As President and CEO of Life Settlement Advisors, Leo has been working in the Life Settlement business since 2001 and has done extensive research into the operational side of the funding groups to better understand how they price their products, manage the risk of pooled life settlements and most importantly understanding the policy due-diligence process.

During this time, Leo has sold numerous policies in the secondary market. He has also worked in the life insurance and estate planning area for more than eleven years.

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