

Life Settlements: Breathing New Life into an Old Life Insurance Policy

As a result of a relatively recent innovation in the life insurance industry, policyholders may now be able to sell an unwanted life insurance policy for a price in excess of its cash surrender value. These transactions, commonly referred to as life settlements, may provide an individual with the much-needed cash to pay for medical care or living expenses, or the funds to pursue a revised estate plan. A life settlement may be a better alternative for certain eligible policyholders than allowing the policy to lapse or surrendering it for its cash value before the benefits are paid.

This report provides a brief overview of life settlements, the most likely candidates for this opportunity, and a cautionary note.

Life settlements are transactions in which a policyholder, who no longer wants to maintain his or her life insurance policy (term or permanent) due to some change in circumstance, sells it to the life settlement provider (the "provider") for more money than its cash surrender value. The provider pays a lump sum cash payment to the policyholder to acquire the ownership rights and obligations of the policy. The provider becomes the new policy owner, is responsible for the premium payments, and is entitled to receive the policy death benefits from the issuing insurance company upon the death of the insured. The original policyholder is now free to use the proceeds to achieve other goals.

There are a variety of reasons why the sale of a policy may make sound financial sense:

- the premiums on the policy may no longer be affordable;
- the beneficiary for whom the policy was originally purchased is now deceased, or the risk insured against no longer exists;
- there is a change in financial circumstances, and liquidity is required;
- a key-man policy, designed to protect a company from the financial loss of a key executive, is no longer necessary either because the business has dissolved or the individual is no longer a key employee; or
- the objectives of a life insurance trust have changed.

Life settlement providers are typically large institutional investors, such as major banks and insurance companies. A potential candidate submits the policy, along with supporting documents, such as medical records, to the provider for an appraisal of the policy's fair market value. The provider then states what it is willing to pay to acquire the policy. Unlike the viatical settlements of the late 1980s, which primarily focused on the policies of AIDS patients, life settlements are not limited to terminally ill insureds with less than a two-year life expectancy. A likely candidate for the life settlement market is a policy with a face amount of \$250,000 or more, in which the insured is 65 years or older, has a remaining life expectancy of between two and one-half to 12 years, and the policy is beyond its two-year contestable period.

The fair market value of the policy is just one factor to be considered in determining whether a life settlement is the right course of action for an insured. The policyholder must consider the tax implications of the

sale (the sale of a life insurance policy may be a taxable event) and the reputation of the provider. A policyholder will want to ensure that the provider has sufficient security safeguards in place to keep the insured's personal data confidential.

A life settlement may provide a policyholder with the flexibility to respond to changes in financial circumstances. While not appropriate for every policyholder, life settlements are worthy of consideration when determining the best way to exit from an unwanted life insurance policy.

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