Life settlements migrate into business market

By Cayce Awe & Joe Young

Traditionally used for policies owned by individuals, life settlements have emerged as a valuable financial planning tool for planners to offer corporations as well. Although businesses have long used life insurance policies as tools to achieve corporate goals (providing benefits, succession planning, etc.), there are many circumstances in which those policies cease to serve that corporate goal and are no longer needed.

Commonly, these policies were then viewed as having little or no value to the corporation. This article will show how planners can use a life settlement to help eligible corporate clients and executives turn unneeded key-person, buy-sell, and split-dollar policies into a valuable liquid asset.

How does a life settlement impact COLI?
Many planners today know that a life settlement is a lump sum cash settlement paid to an insurance policyholder in exchange for contract ownership rights and future premium payment obligations, but few planners associate life settlements with policies owned by corporations. In reality, both individuals and corporations share many common reasons behind the sale such as: change in circumstances, unaffordable premiums, or bankruptcy. Previously, the only option a corporation or business-owner had to cash-out an unneeded policy was to lapse their policies and collect any remaining surrender value minus forfeiture. With a life settlement, corporations can now receive a significantly greater payment. Let's take a look at three different possible scenarios. (For privacy reasons, none of the illustrations given below are taken from actual life settlement contracts, but are instead given to provide the reader with reasonable approximation of possible scenarios clients might encounter.)

Key-Man
Type of policy: Universal Life
Policy face amount: $500,000
Cash surrender value: $35,000
Cash settlement: $85,768 (245% above the CSV)
Reason behind the sale: Policy was purchased to protect the company from the untimely death of a key executive who contributed substantially to the company's revenue flow. Executive has retired and policy is no longer needed. By pursuing a life settlement, the company would be able to liquidate this asset for a value significantly greater than the cash surrender value of the policy.

> Few planners associate life settlements with policies owned by corporations. In reality, both individuals and corporations share many common reasons behind the sale

Buy-Sell
Type of policy: Universal Life
Policy face amount: $650,000
Cash surrender value: $0
Cash settlement: $78,000
Reason behind the sale: 69 year old retiring business owner retains ownership of policy that was purchased to fund a buy-sell agreement. After discussing with his planner it was decided not to continue premium payments, because he already had suitable personal policies to cover his needs. Rather than lapsing and receiving nothing, a life settlement would result in a considerable cash settlement.

Split-Dollar
Type of policy: Universal Life
Policy face amount: $3,000,000 (Net face was $2.75 million due to $250,000 in outstanding policy loans)
Cash surrender value: $725,000
Cash settlement: $1,200,000 (166% above the CSV)
Reason behind the sale: Business owned a $3,000,000 policy on an executive that had retired several years ago. The policy's original executive benefit objectives are outdated and the ongoing premium requirements of the policy are now a burdensome liability for the company. A life settlement transaction would enable the company to replace a current liability with a sizeable asset.

Opportunity
As a trusted planner, it is your fiduciary duty to offer clients the best financial advice possible, especially when it comes to unneeded corporate owned policies where clients may not be aware of alternate solutions. Providing this valuable service to your clients by adding life settlements to your practice can be easy, because many planners already have existing clients that meet basic eligibility requirements. Awareness is key. This fact is echoed in a survey of planners conducted by Maple Life Financial, where despite an overwhelming majority of planners having senior clients over the age of 65, nearly half indicated they still had clients who had surrendered a life insurance policy. Bottom line: If your corporate clients have policies on seniors, then you should screen for life settlement opportunities during your annual review.

What should you be looking for? Basic parameters relate to age, medical condition, policy, and reasons behind the sale. Typical candidates are seniors age 65 who have experienced a major health change, have a life expectancy between 2-12 years, and own a transferable universal life, variable universal life, second-to-die, or convertible term life insurance policy with face amounts greater than $100,000. Common reasons why policies are sold:

- Increasingly expensive premiums
- Changes in business situation
- Need for medical or long-term care
- Bankruptcy
- Divorce
- Departing executives

Step-By-Step

After screening and identifying prospects, begin the process by selecting a professional life settlement broker to assist you in getting the best possible offer for your client. Choose one who is experienced and established with links to institutional life settlement providers with strong compliance and anti-fraud programs. This will help ensure that all issues relating to regulations, licensure, and privacy are properly managed. Next, your broker will submit the policy to providers who will review and issue a purchase offer. Be sure to go over offers with your client and explain very carefully any tax implications. Upon acceptance and receipt of the closing package, your client will receive their cash payment in a matter of days.

Important Considerations

Taxes—Life settlement transactions may be taxable. Although there are no life settlement specific IRS rules, there are common guidelines. First, the amount up to the basis is not taxed. Second, the amount from the basis to the cash surrender value is taxed as ordinary income. Lastly, the amount above the cash surrender value is taxed as capital gains. Because each situation is unique, it is best to obtain expert consideration of tax consequences prior to accepting a life settlement offer.

Regulations—Today, there are 27 states with laws regulating life settlements and 2 additional states with legislation pending. Most state laws are based on the National Association of Insurance Commissioners (NAIC) Viatical Settlements Model Act. Some require licensing, so be sure to know and understand your state's requirements before recommending life settlements to your clients.

Work with professionals—The industry is growing at an astonishing rate. When conducting an Internet search using the keyword "Life Settlement" you are presented with numerous hits of related pages, including lists of many different companies that fund life settlement contracts. Whom should you trust to purchase your policy? Look for companies who are well established, institutionally owned, operated, and funded, and most importantly rated. There are two agencies which offer life settlement ratings, Standard and Poor's and Scope. These agencies carefully evaluate procedures, management, internal controls, financial stability, and serve as a valuable guide in determining your future partner prospects.

A Bright Future

As planners and corporations begin to view Corporate Owned Life Insurance in a new light, they will discover a new and profitable manner in which to turn their unneeded policies into cash. ▲

—Cayce Awe is regional sales manager for Maple Life Financial, a life settlement provider located in Bethesda, Maryland. Prior to joining Maple Life Financial in 2000, Cayce was a Brokerage Manager for Capital Synergies in Baltimore, Maryland. Previously, he spent seven years with M Financial Group firm, Wolf and Cohen Financial Services in Washington, D.C., where he was Director of Marketing and Case Design. Cayce may be reached at 301-873-7993 or cawe@maplelf.com.

—Joe Young is Partner with Chesapeake Financial Settlements, LLC, a life settlement broker located in Rockville, Maryland. Prior to joining Chesapeake, Joe represented Corporate and Endowment Solutions, Inc., a turn-key provider of nonqualified executive benefit planning strategies. Joe may be reached at 240-403-1509 or at jyoung@chesapeakefs.com.