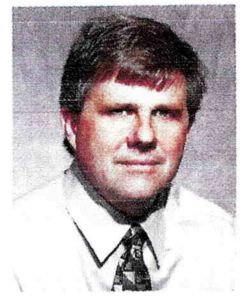
Life Settlements on Premium Financed Policies



Steve Shorrock

By Steve Shorrock, ChFC, CLTC, FLMI

Rarely does a week go by without receiving a call from a broker on a policy that has been premium financed and is approaching the end of the loan period. Many of these financed policies have potentially significant values as life settlements above the loan payoff amount if the policyowner does not wish to pay off the loan or refinance the policy.

We are seeing more and more funding entities that are now open to purchasing unneeded or unwanted life insurance policies that are currently premium financed. Of concern to the funders are policies where the "insurable interest" was questionable at issue. Some premium financing structures can be construed to be STOLI (Stranger Originated Life Insurance), and such policies will be difficult to sell in the secondary market.

From our own experience, the premium financed policies that provide significant value over the loan payoff have the following characteristics:

- Recourse premium financing. When the owner has collateral pledged in addition to the insurance policy, most funding entities are willing to purchase.
- Non-recourse premium financing programs that provide no up front payments or guaranteed sale of beneficial ownership in the trust can work well.
- There needs to be some change in the health of the insured since the policy was issued. Even a change in one table rating provides value. Life expectancies (L/Es) should be less than 150 months.
- Premium to Death Benefit ratio needs to be 5% or less. Policies that include a term blend are valuable, as this reduces the Premium/Death Benefit ratio.
- Interestingly, non-guaranteed policies that provide Cash Surrender Values are more valuable than guaranteed policies that provide no future CSV.

Here are two good examples of recent secondary market purchases of premium financed policies:

Example 1:

An irrevocable life insurance trust (ILIT) owned a $12 million UL policy issued in 2002. Premiums were financed through a recourse loan with AI Credit. Insured was a 71 year-old male and suffered from Type II diabetes, diverticulitus and hypertension. Policy Cash Surrender Value was $1.4 million and the outstanding loan was $2.725 million. Minimum premiums to maintain the policy to maturity were $417,888 annually. The trustee was looking to settle the policy and retire the loan. Policy was settled for $3.984 million (33% of Death Benefit). This allowed the trustee to retire the loan and fund the trust with the balance of funds totaling $1.259 million.

Example 2:

A LaSalle Bank/Coventry First premium financed policy on a 76-year-old female with hypertension. The Death Benefit was $6 million, average L/E's of 160 months and minimum premiums to age 100 were $318k annually or 5.3% of Death Benefit. The loan balance, 26 months after the policy was issued, was $433k and the policy had a Cash Surrender Value of $100k. The policy was purchased by an institutional funder, providing $635k to the trust. This paid off the existing loan and the trust received $200k.

Life settlements can be a wonderful exit strategy and provide financial advisors the opportunity to reconnect with clients and sell them new services. Various financial journals and research papers indicate that the life settlement market continues to grow exponentially. Life settlements provide an additional "tool" to financial advisors that potentially generate value to the client well in excess of the insurance companies' Cash Surrender Value (CSV). Since 2007, policyholders who have worked with Select Life have received $18 million in excess of the CSV. FA

Steve Shorrock is President of LifeVentures Corp, which designs new life insurance products and develops marketing concepts for agents, and Co-Managing Director of Select Life Settlement Corporation, a life settlement firm that brokers seniors' unwanted or unneeded life insurance policies. You can reach him at his Northport, Long Island office at 631-239-6655 or steve@lifeventurescorp.com