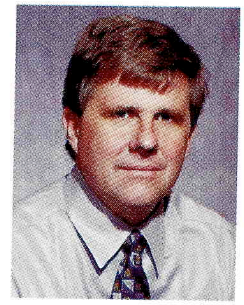
Which Types of Policies Work Best?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By Steve Shorrock, ChFC, CLTC, FLMI

The good news for seniors looking to shed an unwanted life insurance policy without simply surrendering or lapsing it is that the life settlement market most likely has a place for them. Life settlements have seen tremendous growth in the past year with approximately $12 billion in face amount being sold in the secondary market.

While this number is still a fraction of what some predict will be the size in 10 years, it still represents a significant increase over the prior year. Life settlements are becoming more of a mainstream asset class and a growing number of financial institutions have entered this market.

I receive phone calls on a daily basis from agents about the viability of selling a life insurance policy in the secondary market. Since life insurance is property, insureds have the right to sell a policy which has become unwanted or unneeded. The value provided to consumers is often multiples of the cash surrender value if they were to "settle" (surrender or lapse) with the insurance company.

Alarmingly, 88% of all UL policies never result in a death claim, according to the leading actuarial consulting firm of Milliman and Robertson. All too often, contracts which might have substantial value as life settlements are simply surrendered or allowed to lapse.

The (potentially) bad news regarding life settlements is that, as with any other marketplace, some products are more in demand than others. Essentially, the secondary market is not significantly different from the primary market. Life insurance carriers will sell coverage within certain parameters based on their underwriting and funders of life settlements will buy polices based upon their own investment criteria.

In addition, many providers work with several different funders, and may therefore be working from several different sets of parameters. The market may have room for all types of life products, but some are much more popular than others.

In general, the sweet spot for providers is a **Universal Life** policy with premiums of less than 5% of face value and not too much cash. UL policies are favored because of their flexibility. With Universal Life, there's no fixed premium schedule and the policyholder can pay only the minimum premium required to keep the policy in-force.

The next most popular type of policy is **Convertible Term**. It is very common for term insurance to include an option that would allow conversion to UL policies up to a certain age. Some funders will make an offer contingent upon being able to convert it to a UL policy.

Regarding Convertible Term, life settlements can potentially provide a large cash asset for the client as an alternative to lapsing the term policy for no value. For the agent, they also generate a conversion commission (as the term policy is converted prior to sale) as well as earning a commission on the life settlement and earning UL renewal commissions for the life of the insured.

In addition to UL and term policies, there is a market for products such as **Survivor** or Second-to-Die coverage. But the circumstances would have to be a good fit for the buyers, such as one spouse already deceased or both with similar or relatively short life expectancies.

Less preferable are **Whole Life** policies as these are much more rigidly structured without the same flexibility of a UL. The funder could not take money out of a Whole Life policy except through a loan, whereas a UL policy allows for more ready access. Also, Whole Life typically has higher premiums and a higher cash value, both detrimental to a sale in the secondary market.

Variable Life policies can be as challenging to settle as Whole Life. There is only a small group of funders looking for variables due to the complexity of the product. And since FINRA, the Financial Industry Regulatory Authority, has determined that Variable Life insurance policies are considered securities, the parties who can sell, buy, transfer or be compensated for transactions are governed by laws and regulations in addition to applicable life settlement regulations.

Life settlements can be a wonderful exit strategy and provide financial advisors the opportunity to reconnect with clients and sell them new services. Indeed, you have the fiduciary responsibility to discuss this option within your clients' financial plans, especially when older clients are considering the lapse or surrender of a policy. FA

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