

Life Settlements

A Lifeline for Sinking Policies

by Eric Lund

In today's topsy-turvy sea of uncharted economic waters, smart advisors are prepared advisors. Knowing how to weather the storms and having the right instruments is vital. This is particularly true when facing under-performing policies in the non-qualified retirement plan marketplace. During the late 1980's and early 1990's large amounts of non-qualified retirement plans were funded by universal life general account policies, due to their unique tax advantages. At the time of issue, many of the policies were crediting near 10%, with premium and cash accumulation projections reflecting those assumptions. Today, that figure has fallen and most of those policies are now crediting at a much lower level – many in the vicinity at or near their minimum guaranteed interest rate.

What happens when these plans don't perform as expected? Under-performing policies impose a financial strain on an organization's cash flow and jeopardize its ability to fulfill financial obligations. When improperly funded, due to skipped premiums, lack of adjustments to changing credit rates, or in the case of variable policies failure to meet projected returns, policies quickly begin a downward plunge. At best, this lack of performance may be viewed as an inefficient use of capital. At worst, it may result in serious tax consequences due to lapsing policies with outstanding loans. Under-funded policies also increase the net amount of risk. Combined with the higher cost of insurance for older individuals, they result in substantial premiums. With less premium going toward cash accumulation and more toward costs of insurance, the policy is no longer able to fulfill its primary objective. These problems are only magnified when factoring in retired employees.

What should a financial professional do to rectify these problems? In the past, few options were available: You could swallow hard, pay the higher premiums, and hope to recover some of your cost upon death of the insured; or you could admit defeat, surrender the policy, and pay the retiree from the corporate coffers. But now, thanks to the creation of the life settlement, a new option exists, one that could be a lifeline for sinking policies.

What exactly is a life settlement? A life settlement is the sale of an in-force life insurance policy for a lump sum payment that is always greater than the cash-surrender value. The purchaser becomes the new owner and pays future premiums. Overall, the process is quick, easy, requires no medical exams, and best of all; clients are free to use the proceeds however they wish.

First emerging in the late 1990's, life settlements have grown in popularity and today are accepted by the insurance, financial, and legal communities as a valuable financial planning option. However, despite the rapid growth, many financial professionals remain unaware or unfamiliar with the concept of using third-party market valuation of life insurance policies as a tool in recommending appropriate investment and planning strategies for their clients. In addition, many registered financial advisors are subject to restrictions imposed by their broker-dealer. Such restrictions are expected to be reduced as the broker-dealer community becomes more familiar with the concept and benefits of life settlements, particularly for registered representatives who deal with funding companies built for the institutional marketplace, carry E&O coverage, and maintain compliance departments staffed by professionals in the insurance and securities markets.

What should you do when a valued client is faced with under-performing policies? Financial professionals who perform reviews of these plans for their clients should consider a life settlement as an alternative to surrendering policies whenever they encounter under-funded plans. "If policies are not reviewed properly and premiums not adjusted accordingly, these types of plans are likely in trouble...In situations like these the consideration of the life settlement option is a must," says Michael T. Rodman, a San Diego based Certified Financial Planner and President of Advanced Planning Services Inc. According to Bob Dimeo, managing principal of Los Angeles based Highland Capital Brokerage, "Most conscientious agents understand the importance of an annual policy review. However, many fail to recognize

the potential of the life-settlement option. We continually run into cases where we are able to rescue or improve under-performing plans through the use of a life settlement."

How do you initiate the life settlement process? Begin by taking the following steps:

- Order new in-force illustrations funding the policy to maturity.
- Obtain releases to collect medical and policy information from the insured and policy-owner.
- Solicit offers from institutionally funded life settlement providers.
- Give your client a thorough analysis listing all alternatives, such as: surrender the policy for its current cash value; pay the adjusted premium; or choose the life-settlement option if the policy qualifies and an attractive offer was received from a reputable provider.
- Armed with thorough information, make your recommendation based on what is in the best interest of your client.

Not all policies and insureds will qualify for a life settlement. Basic parameters require the insured to be age 65 or older, to have experienced a change in health since the policy was issued, and to have a life expectancy between two to 12 years. Other parameters include minimum policy face amounts, carrier ratings, and transfer and contestability issues. Life settlements should not be confused with viatical settlements, which deal with terminally ill insureds of any age with a life expectancy of two years or less.

If you work in the non-qualified retirement plan arena, undoubtedly, you will encounter the types of policies discussed in this article. With the advent of life settlements, you now have another alternative to present to your clients. A life settlement may very well be the lifeline needed to rescue a sinking plan and turn a bad situation into a positive one for a valued client. □

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