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IDEAS FOR LIFE AND HEALTH PROFESSIONALS



Health Insurance and Associated Benefits

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What Every Producer Needs To Know About Life Settlements

Almost overnight, life settlements seem to have moved from the periphery of the life insurance business to center stage. To make the point, enter “life settlements” in a Google search and you will find nearly 22 million entries.

The most common question producers should ask is *how to recognize when a life settlement might be appropriate*. Here are six situations that will serve as a guide.

1. An alternative to surrendering a life policy. There are circumstances in which a policyholder no longer needs the coverage. Changes in people’s lives can easily alter, reduce or eliminate their need for existing insurance.

A life settlement makes it possible to maximize the value of the existing insurance by selling it in the settlement market.

It’s worth noting that quite often, if the policy has cash value, the market value can be higher than surrendering the policy for only its cash surrender value.

A divorce is a case in point. When there’s no longer a need to protect a spouse’s income, or there’s no appropriate alternate beneficiary, a life settlement is a beneficial alternative to allowing a policy to lapse.

Here is an example: Because of a divorce, the client, a 64-year-old male with a \$1.5 million 15-year term life policy, no longer needs the full death benefit. Working with his advisor, he decides to convert just enough of the policy—\$400,000 of the death

benefit—so he could continue paying the same premium.

The remaining \$1.1 million term conversion was put up for sale. The total offer was \$213,000 with \$154,000 going to the client and the remainder split between the agent and the settlement broker. The agent made three sales: a \$400,000 term conversion with a \$9,000 commission, a \$1.1 million term conversion with a \$28,000 commission, and a settlement fee of \$40,000. In addition, the producer created a renewal income stream for himself.

Should an insured outlive beneficiaries, putting the policy up for sale in the settlement market may be a way to recoup the premiums paid, and perhaps more.

There are also situations in which the owner of a policy can no longer afford to pay the premiums. What was once a sound and essential asset can often turn into an unneeded expense or even a burdensome liability.

Producers should be alert to other liquidity needs, such as situations in which there may be a long term illness, interest in funding a grandchild’s education, or dealing with a bankruptcy.

There can also be the need to ease the burden of living in difficult economic times. The proceeds of the sale of a life policy can be used to fund an annuity that will produce an income stream and may still have some accumulation value left for their heirs upon death.

2. A 1035 alternative. A client may need to purchase a new policy with a larger death benefit or may currently have a policy that is underperforming. In such situations, it is worthwhile to compare the market value of the policy with the cash surrender, 1035 value, which would be available to help reduce future premiums or purchase an additional death benefit.

This can result in multiple sales for a producer, including the sale of the current policy and, perhaps, funding an annuity to then pay the premiums for a new life policy. Also, the agent of record would continue to receive renewals on the policy sold.

3. A term life policy's conversion period is about to expire. Within two years of a term conversion expiration date, a producer should engage the policyowner in a discussion of available options. Converting and selling the policy may be an appropriate scenario that could result in multiple sales, including the sale of the current policy, converting the current term policy and, perhaps, funding an annuity that could pay the premiums for a new life or long term care policy.

4. A need for either more life insurance or a more appropriate type of coverage—particularly as a client accumulates wealth. Selling an existing policy to help fund the right type and amount of insurance is a solution that can help clients reach their financial goals.

There are a number of possibilities, such as helping finance the purchase of an insurance product that better suits a client's current circumstances, i.e., long term care insurance, annuities and survivorship policies.

A change in a family situation is another opportunity, particularly as children leave the nest, adults retire or a mortgage is paid off. A survivorship policy may be the solution for minimizing estate taxes so the accumulated wealth can be left to heirs intact.

There are times when life insurance is no longer necessary, but protecting assets through the purchase of long term care insurance can be a priority. The proceeds from the sale of a policy can help fund this type of product, either directly or through an immediate annuity that will pay the premium.

In the instance when a family's estate has been diminished by the downturn in the stock market, the effect may very well be that the amount of life insurance needed for estate tax planning purposes has changed.

As estate tax laws continue to be a moving target, many clients need to make adjustments to their life insurance portfolios. Purchasing additional death benefit with the use of proceeds from the sale of an existing policy or simply just settling an existing policy can help protect, expand and support a client's financial fitness.

5. Sale of a business or a key person termination. As an alternative from allowing life policies to lapse or cash surrendering, life settlement may be a beneficial option.

There are situations in many businesses in which the liquidation of corporate-owned life insurance is appropriate, such as policies on key employees who have retired or who are no longer employed by

the company. Life settlement can be a way to recoup premium payments and perhaps additional monies.

This can also apply when a company can no longer afford the premiums for life policies for employees involved in buy/sell agreements or for those who have left the company.

Times change, and life policies may be valuable company assets, particularly in difficult economic circumstances.

6. Extended care needs. A policyholder may require additional liquidity for current living expenses more than a death benefit for the family. The sale of a life insurance policy could provide cash for uncovered medical expenses or in-home care for a client who has been diagnosed with a life-threatening illness.

In addition, there are policyholders who may qualify for an impaired risk annuity that could help increase their cash flow from the settlement.

Just because life settlement has become popular as a way to leverage financial assets, it is not the solution for every situation. If the reason for purchasing a life insurance policy in the first place was to provide liquidity upon the insured's death and that has not changed, then it is only appropriate that the policy remain in force.

That said, it is clear that life settlements offer options for those with changing situations and needs that may not otherwise have been available. This is why it is critical that producers arrange annual policy reviews with clients to identify possible life situation changes that may impact an insurance program. 🌐