



# The Wealth Counselor

A monthly newsletter for wealth planning professionals

From **Henry Weatherby**

Volume 2, Issue 7



## Life Settlements: Understanding the Opportunity for Your Clients

This month's issue of The Wealth Counselor addresses a topic that many professionals do not understand fully, life settlements. For the right clients, a life settlement offers a significant advantage over the alternatives - and one that the client and the planning team should at least consider.

### Life Settlements - The Basics

The secondary market for life insurance policies has entered the mainstream of financial services products. Therefore, advisors whose clients include seniors or aging baby boomers should have a working knowledge of how a life settlement can provide liquidity to meet a variety of estate planning and elder care needs.

A life settlement is a product for seniors (generally over the age of 70) who are seeking an economically sensible exit strategy from unwanted life insurance policies. A life settlement transaction involves the sale of an existing life insurance policy, typically valued at \$250,000 or more, to an institutional investor (known as a "provider") in exchange for a lump-sum payment greater than the cash surrender value, but less than the death benefit. The institutional buyer becomes the new owner of the policy, assumes responsibility for premium payments, and collects the death benefit upon the insured's death.

**Planning Tip:** Where the owner/insured no longer needs or desires a life insurance policy, a life settlement can generate significantly more income than a policy surrender. As long as the life settlement payment does not exceed "basis" or the premiums paid for the policy, the payment will not be subject to income tax.

Based on industry statistics, the average life settlement candidate is a 78 year-old male who owns a universal life insurance policy valued at \$1.8 million, and the average lump sum payment typically

**Weatherby & Associates, PC**  
34 Jerome Avenue  
Suite 310  
Bloomfield, CT 06022  
860-769-6938

Our firm focuses our practice on Estate Planning, Business Planning, Trust Administration, Probate and Elder Law. We help families preserve and protect assets and values. For business owners we help them Maximize Their Businesses' Value.

ranges from 3 to 5 times the cash surrender value. In addition to universal life insurance policies, most other types of life insurance policies may qualify for a life settlement, including variable universal life (VUL); term policies (if convertible); whole life; survivorship; and group policies (if portable and convertible).

**Planning Tip:** Life settlement offers from providers can vary widely. To obtain the highest possible value for a client's life insurance policy, advisors should seek the services of an experienced settlement broker who can shop the market and obtain multiple offers from providers authorized to do business in the state in which the policy ownership resides. A listing of settlement brokers operating in the secondary market is available online at: [www.lisaassociation.org](http://www.lisaassociation.org).

### **Life Settlements for VUL Policies Are Securities Transactions**

Although universal life insurance policies comprise the bulk of life settlement transactions, VUL policies - particularly those with investments in subaccounts that have not performed according to market expectations - may be prime candidates for settlement in the secondary market. In August 2006, NASD issued Notice to Members 06-38 addressing member obligations with respect to the sale of existing VUL policies to third party investors operating in the secondary market for life insurance. This notice reminded us that, according to the NASD, the sale of a VUL policy is a securities transaction subject to applicable NASD rules.

Those elements of Notice 06-38 directly impacting the handling of VUL life settlement transactions concern:

1. Establishing the client's suitability for the product;
2. Conducting due diligence on the confidentiality practices of brokers and providers;
3. Performing "best execution" by soliciting bids from multiple licensed providers;
4. Establishing written procedures involving product training and supervision; and
5. Prohibiting the payment of compensation on a transaction except by another member firm (broker-dealer).

Some broker-dealers have taken the position that although they will not proactively promote or advertise the product, they are putting procedures in place to make the option available to their registered reps in situations where a life settlement may be the most suitable solution for the client.

**Planning Tip:** Following the issuance of NASD Notice 06-38, many independent broker-dealers began screening life settlement brokers and establishing preferred vendor relationships to service this business from their registered reps. Financial advisors should check with the broker-dealer home office regarding the procedures for transacting a VUL life settlement and any preferred vendor relationships.

### **Life Settlements for Trust-Owned Life Insurance**

As baby boomers prepare themselves for the great wealth transfer, financial advisors and legal professionals are poised to establish more trusts. According to the results of the sixth annual "Industry Attitudes" survey published in October 2006 by InvestmentNews, 70 percent of the financial advisors responding to the survey indicated that they expected to set up a greater number of trusts for their clients.

This statistic is important because life settlement industry statistics indicate that approximately 40 percent of life insurance policies sold in the secondary market involve trust-owned life insurance policies. For financial and legal professionals acting as trustees or fiduciaries for trust-owned life insurance policies, or for any professional whose clients have trust-owned life insurance, conducting periodic reviews of policy performance is highly recommended.

For example, policies purchased with the expectation that policy values or dividends would be available to pay future premiums may now require additional premium payments to maintain coverage. In some cases, the trust makers may choose a life settlement for the underperforming policy and then use the proceeds from the life settlement toward replacement coverage with a better-performing product.

**Planning Tip:** All wealth planning professionals whose clients have trust-owned life insurance should consider engaging an insurance professional with expertise in conducting regular policy reviews. Life insurance policies are complex financial instruments, and once a trustee discovers that a trust-owned life insurance policy is at risk, they will want to discuss all possible options with the insurance professional and the insured.

### **Common Uses for Life Settlements**

There are numerous reasons why seniors choose a life settlement, but some of the most common scenarios are: (1) the preferred alternative to a 1035 exchange; (2) the insured's estate tax burden

has decreased and thus the insured no longer needs liquidity to pay estate taxes; (3) the insured wants cash to give to family or their favorite charity; (4) the insured can no longer afford the policy or plans to surrender it; (5) the policy is a key-person policy and no longer needed by a retiring executive; (6) the insured needs funds for medical or long-term care.

**Planning Tip:** Life settlements are often preferable to the client accepting a low cash surrender value or surrendering the policy.

### Conclusion

Within the past five years, the secondary market for unwanted life insurance policies has grown exponentially and is now estimated to be a \$20 billion industry. Due to increased regulatory oversight and the infusion of institutional capital from investment banks such as Credit Suisse, Bear Stearns, Goldman Sachs, Deutsche Bank, and foreign and domestic hedge funds, this emerging industry is approaching a plateau of tenability and maturation.

Consider working with an experienced insurance professional to conduct periodic reviews of your clients' life insurance policies, and if suitable, recommend a life settlement.

Member of  
The Advisors Forum

*To comply with the U.S. Treasury regulations, we must inform you that (i) any U.S. federal tax advice contained in this newsletter was not intended or written to be used, and cannot be used, by any person for the purpose of avoiding U.S. federal tax penalties that may be imposed on such person and (ii) each taxpayer should seek advice from their tax advisor based on the taxpayer's particular circumstances.*

*For professionals' use only. Not for use with the general public.*

You have received this newsletter because I believe you will find its content valuable, and I hope that it will help you to provide better service to your clients. Please feel free to [contact me](#) if you have any questions about this or any matters relating to estate planning.

To be removed from this mailing list [unsubscribe](#) here.

Weatherby & Associates, PC 34 Jerome Avenue Suite 310 Bloomfield, CT 06022 [Website](#)