



## Life Settlements

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Life Settlements. Most people have never heard of them, let alone how such a thing can benefit them. The technical definition for a Life Settlement is: “the sale, assignment, transfer, devise, or bequest of the death benefit or any portion of an insurance policy or certificate of insurance for compensation less than the expected death benefit of the insurance policy or certificate.”

Simply put, a Life Settlement is a transaction where an insured person sells their policy to an investor for a sum of money. The seller gets a nice lump sum payment to enjoy and use, while the investor receives a payout when the policy terms. This transaction benefits both the seller and the buyer, a win-win situation for both.

### **An Introduction to Life Settlements**

Concerns about money are common for most people as they look ahead towards retirement. Consider the following facts:

- The average life expectancy in the United States was 77.4 years in 2004.
- The average age for retirement was just under 63 years old.

What this means is that the average American must plan for around fourteen years of living off of existing savings. Several factors can cause your savings to shrink even faster than anticipated, such as increased medical costs as you age. You must also contend with the notion that no plan is ever perfect – there will be expenses that even the most savvy financial planners have no way of anticipating, things that none of us have control over. Mr. Murphy has the unfortunate habit of stopping by to visit at inopportune times in our lives.

None of us like to think too much about our own deaths, but in this day and age it is a must. No one wants to leave their children and loved ones with nothing (or even worse, in debt) when they pass on – to provide for our loved ones is the very reason that many of us work as much as we do. We simply want to leave them better off, and at the very least, not burden them with our final expenses. How can we prepare for this? **We buy life insurance.**

Life insurance is an important part of planning financially for the latter years of our lives. It gives us the comfort of knowing that our loved ones will be financially secure when we are no longer around. For many, this is a superb solution to the problem. For some, however, life insurance does not remain a viable solution, even if it did at first.

There are many reasons you may not want to continue paying for your life insurance policy, but would like to at the very least recoup the money you have put into it:

- The policy is no longer needed or wanted
- To pay for existing healthcare costs
- Premium payments have become unaffordable
- Considering lapse or surrender of the policy
- Changes in estate planning needs

Fortunately, a solution now exists: Life Settlements (also known as a Viatical). This emerging market allows the insured to “cash out” on their life insurance policies by selling them to an investor and enjoying a percentage of the return right now. In turn, investors (whether individuals or business entities) pick up the monthly cost of the policies and become the sole beneficiary of the policies. The seller gets cash now, while the investor gets a payout at a later date.

### **A Brief History of Life Settlements**

The concept of insurance has been around for thousands of years. Over 5,000 years ago, merchants in China purchased insurance as a preventive measure against losses incurred by pirates at sea. However, it wasn't until the late 17th century that the practice of procuring insurance began to gain acceptance in the Western world. Though it was illegal almost everywhere in Europe, the British promoted the purchase of insurance as a means of risk mitigation, planting the seeds of the modern insurance industry.

Life insurance began to overcome widespread resistance from religious groups in the mid 19th century, after several large-scale disasters (the New York fire of 1835 and the great Chicago fire of 1871) illustrated the need for a means to deal with sudden and large losses. Over the next few decades, the practice of insurance became an even larger part of society, spurred in part because of the advent of the automobile.

The practice of reselling life insurance policies remained relatively uncommon until the AIDS epidemic heightened in the late 1980s. AIDS caused many young individuals with severely shortened life expectancies to suddenly be faced with a dire need for cash, both to pay for medical expenses and to allow them to live the rest of their lives with dignity. As policyholders stricken with this tragic disease realized that there was a value to their policies, many turned to their life insurance policies, cashing out the equity that they had built up.

Unfortunately, this equity would sometimes prove to be inadequate, leading to searches for other avenues to which they could secure even greater sources of funds.

Their shortened life expectancies caused investors to be willing to offer more than the cash surrender value of the policy in order to purchase the policy. In return, the investor becomes the sole owner and beneficiary of the policy in exchange for immediate money that was greater than could otherwise be expected by the policyholder. Put simply, the market for Life Settlements became established when the market price for insurance policies exceeded the regulated price offered by insurance companies.

### **Cash Surrender Value**

The amount available in cash upon cancellation of an insurance policy before it becomes payable upon death or maturity is the Cash Surrender Value.

Thus was born the Life Settlement industry. In recent years, the original impetus – providing funds to AIDS patients – has broadened to include two categories of policyholders.

1. Policyholders suffering from terminal illnesses other than AIDS – can also generally refer to insured persons with less than 24 months to live (Viaticals)
2. Policyholders not suffering from terminal illnesses (Life Settlements)

Keep in mind that the term Life Settlement has come to include both categories of policyholders listed above. Unless otherwise specified, we will use the term Life Settlement as a catch phrase referring to both.

### **What is a Life Settlement?**

A Life Settlement is an existing life insurance policy sold to a third party for more than its cash surrender value but less than its net death benefit. Typically, these transactions involve individuals who, though not terminally ill, wish to sell a life insurance policy they no longer need. There are a variety of reasons a policy would no longer be needed - perhaps it was purchased to meet estate-planning needs that no longer exist, or perhaps a corporation owns the policy on an executive who has left the company. Whatever the reason, the policy has become a financial burden that the owner no longer wishes to bear.

The term Life Settlement is interchangeable with Viatical Settlement. Senior Life Settlements refers to Life Settlements with insured persons at least 65 years of age. The word Viatical has an interesting history:

Latin: In the days of Roman legions, a “viaticum” was the money and supplies given to officials before embarking on a risky journey.

Christianity: For ancient Christians, a “viaticum” was a communion offered to a dying person.

Today, Life Settlements have become a very important factor in the estate planning process for senior citizens. Prior to the emergence of the Life Settlement industry, if a senior citizen owned a policy that was no longer wanted, needed, or affordable, there was no option other than to cancel the policy, let it lapse, or surrender it back to the insurance

carrier for the cash surrender value. Life Settlements allow these individuals to use the money in ways that are beneficial to them and their families, allowing them to maintain the quality of their lives and take advantage of financial opportunities that may arise. Life Settlements can have a very positive impact on people's lives.

With the increasing proliferation of Life Settlements as an investable asset class, life insurance companies now face competition for the surrendered policies that they once had a monopoly over, to the benefit of those seeking more money for the policies they no longer need or want. The financial flexibility that Life Settlements give can leave sellers with a peace of mind unavailable through traditional insurance companies.

#### Facts about Life Settlements

- Financial advisers and planners use Life Settlements as a sophisticated planning tool – policies once considered all but useless are now used as tools to allow people (frequently retired seniors who need money and don't want to shoulder the monthly premium costs) to develop or bolster an income generating portfolio.
- The most common sellers of life insurance policies are affluent people over age 65. Typically, they have paid off their homes, and their children have moved out. Selling their policy gives them more options in generating funds for retirement. In addition, persons of this age group give the investor the largest potential return on investment, meaning that the investor will be able to offer them a much higher purchase price for their policies.
- Life Settlement financing typically comes from institutional investors.

#### **For what reasons would a policy owner want to sell their life insurance policies?**

##### *Individual Policyholders*

Some may question why an individual would want to sell their life insurance policies. After all, when the policy terms, it would be worth more than the Life Settlement payout. Besides not needing/wanting or being able to afford the policy anymore, a terminal illness or catastrophic, life-threatening disaster not only deprives a person of the ability to work and earn income, but also can rapidly exhaust savings. When this happens, a Life Settlement allows an insured person to:

- Continue receiving necessary, quality healthcare
- Have a way to ease financial strain
- Continue to live with financial independence
- Compensate for lost income
- Retain control over his/her own life
- Live a quality of life not affordable to someone on public assistance.

A survey of insured persons revealed that they had used their proceeds for a broad spectrum of purposes, including (but not limited to):

- Continuing the highest quality health care possible
- Paying off debts

- Distributing the proceeds of their Life Settlements to whom they wish – spouses, friends, life partners, loved ones, charitable institutions, schools, and hospitals, to name only a few – giving them the peace of mind that comes with knowing the proceeds were distributed according to their wishes, while allowing them to share in the joy of those receiving the gifts
- Taking that special vacation they had always wanted to experience, but never had the time nor the money to take
- Starting a home business in order to continue generating monthly income for themselves
- Planning their own funerals, relieving their loved ones of the stress of doing so
- Re-organization of insurance coverage, perhaps switching from owning a life insurance policy for each spouse to a Survivorship Policy.

/The Healthcare system of the United States sometimes creates a situation where the patient, doctor, and healthcare insurance companies are at odds over what constitutes proper and necessary healthcare. For more reading on the matter, please refer to the General Accounting Office report GAO-05-63SP January, 2005.

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