

Robin & Peter on LIFE SETTLEMENTS



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Informing Your Clients about Alternatives to a Life Settlement

In recent newsletters, we have pointed out the duty that producers have to make their clients aware of the option of a life settlement for policies that are about to be lapsed or surrendered. **As a trusted advisor to your clients, however, it is also your responsibility to tell them about the alternatives to a life settlement.**

A life insurance policy is uniquely valuable property and the benefits of an existing policy that is lapsed, surrendered or sold as a life settlement are usually impossible to duplicate. If, after transaction costs and administration expenses, a policy is a good investment for a third party, it would likely be an even better deal for the insured's beneficiaries to hold on to it without any of those additional costs. Every effort should be made to help a client keep their life insurance policy before resorting to a life settlement.

Policies offered up for a life settlement generally fall into either of two categories: (1) the policy is no longer wanted or needed, or (2) the policy is no longer affordable. Each category offers different alternatives to a life settlement.

When a policy is no longer wanted or needed, it is generally because the reason for its original acquisition no longer exists. For personal insurance this could be because the intended beneficiary has predeceased the insured. For a business purpose policy (buy-sell, fringe benefit or key person) the insured may have left the business through retirement or sale or dissolution of the business. For a trust-owned policy held for estate liquidity, the insured's projected estate tax liability may have declined.

For these types of situations, where the insurance is no longer needed, advisors should determine if the policy can be repurposed. Perhaps there is another personal beneficiary who could really benefit from the proceeds? Maybe the insured is in another business venture which would find the policy useful? Possibly a new or different trust that addresses other estate planning needs could be a successor owner of the policy? Finally, don't overlook the possibility that there is a charity that the policy owner might want to benefit.

If, on the other hand, the policy is still wanted, but the policy owner's finances are driving the need to terminate the policy, different remedies might be considered. To pay premiums, explore the possibility of premium financing with an institutional lender, a family member or even a business under a split-dollar type arrangement. Perhaps the face amount can be lowered or the policy placed on reduced paid-up? Have the policy owner consider gifting the policy to relatives or a charity that would benefit from the policy and can afford to pay the premiums.

Sometimes, however, the policy owner's finances are so dire that simply relieving them of the premium obligation is not enough and they need cash from the policy for living expenses. In such an instance, accessing the policy's cash surrender value, if any, through a loan or withdrawal might get the policy owner over the hump in the short term. However, circumstances requiring a longer term solution might indicate the need to surrender the policy or to investigate the life settlement value.

Finally, the plight of a terminally ill insured must be considered. This situation harkens back to the 1980s and the origins of "viaticals" when investors bought policies to help AIDS patients handle costs for their medical care and living expenses for the last year or so of their lives. It should go without saying that everything possible should be done to help a terminally ill insured retain their policy. Today, many policies offer accelerated death benefit riders which can provide a terminally ill insured with an advance on the death proceeds prior to death. Although the specific terms of these riders vary by company, they should certainly be investigated before considering a viatical settlement for someone with a terminal illness.

To best serve your clients, a life settlement should only be considered along with all the other options available to them. **If, however, it is concluded that the policy would otherwise be lapsed or surrendered, the possibility of a life settlement should undoubtedly be investigated. Failing to maximize the value of a policy that is about to be terminated could be a very costly disservice to your clients.**

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