Robin & Peter on LIFE SETTLEMENTS

March 1, 2017

A Life Settlement and Replace Strategy that Remains Viable

The days of selling a policy in a life settlement and replacing it with a new one are mostly gone, but one variation on that strategy can still work in the right situation.

About 15 or 20 years ago, in the early days of life settlements, it was not uncommon to hear of situations where an existing policy was sold and replaced with a new policy. That such a transaction could occur was largely due to overly short life expectancies that were common at the time. Aggressive underwriting or pricing by the company issuing the new policy could also play a role. But today, with life expectancy companies having had much more experience, their life expectancy evaluations are much longer and more closely resemble insurance company mortality assumptions.

As a result, sell and replace has mostly disappeared, but can still occasionally work in one special situation - the sale of a single life policy and the purchase of a new survivorship policy. Here's an example:

An $8.4 million policy on an 83-year old male was purchased in a trust eight years ago to pay estate taxes. At the time, an individual policy, rather than a survivorship policy was bought to provide flexibility with the proceeds in case the surviving spouse needed money.

Due, in part, to declining interest rates, the policy became underfunded. Premiums were projected to rise drastically from the current premium of $451,000 which would also have the collateral effect of increasing the taxable premium gifts needed to be made to the trust. A life settlement offer was obtained that would net $2,450,000 after taxes.

The insured's wife, age 80, was a standard risk. A new $8.4 million survivorship policy was obtained on both of them with an annual premium of $435,000. The *proceeds of the life settlement will pay the premiums on the policy, without any additional outlay, for approximately 5 to 6 years and will provide gift tax savings as well.*

Before embarking on such a strategy however, there are number of considerations that must be taken into account:

- First, the sale of a life insurance policy, especially on someone who is now highly-rated or uninsurable is the sale of irreplaceable unique property.

- A survivorship policy pays only on the second-to-die, which is a substantially different benefit than a single life policy. In this case, it was concluded that the surviving spouse would no longer have any need for the proceeds and the policy was solely required for estate tax purposes.

- A life settlement can have significant income tax consequences. So income taxes must be taken into account to decide if the after tax proceeds of the life settlement makes the strategy financially viable.

- If the policy is owned by a trust, it must be determined if the terms of the trust would permit such a strategy or if a workaround is possible.

- Don't overlook the possibility of a single life policy on the healthy spouse, as the pricing could occasionally compare favorably to a survivorship policy with one uninsurable.

While sell and replace on the same insured in the life settlement market has gone the way of the dodo bird and become extinct, in the right situation a life settlement and replacement with survivorship (or single life on the spouse) can be a financially attractive change for your clients.

As opportunities surface, be sure to give us a call. We will be glad to help you do an analysis to determine if you could present a better alternative to your client.

Contact us:

Robin S. Weinberger, CLU, ChFC, CLTC

(617) 451-3343

Peter N. Katz, JD, CLU, ChFC

(860) 539-4526