

How to Cash in on Your Own Life Insurance Policy

by Mark B. Leeds

You are 70 years old, give or take a few years, and you are paying tens of thousands of dollars each year for a life insurance policy you've held for quite a while. Your children are grown and established, and they no longer need the protection of the policy. You are tempted to let the policy lapse, or surrender it for a pittance. The premiums are burdensome, and you wish you had the cash for investment or an indulgence. There may be a solution for you.

Life settlements, a fairly new and relatively unknown asset class, are a means whereby seniors can sell their policies to "providers" who will purchase the policies and bundle them for institutional investor funding sources. The senior will receive proceeds well in excess of the surrender value — the sum an insurance company will pay when a customer opts to voluntarily "cash-in" a policy prior to death or the policy's maturity.

For example, a 70-year-old person in reasonably good health, with a \$1 million policy that has a surrender value of, say, \$10,000, could expect to receive a lump sum of \$75,000 or more. In contrast, a Maple Life Financial survey in 2005 revealed that half of responding seniors, unaware of the settlements option, turned in their policies for the much lower surrender value.

The escrow-protected transaction, which is simple and cost-free, is taxable and involves actuarial tables and a medical/health questionnaire for mortality ratings, similar to that used when the policies were first sold. Note that upon the sale, the senior no longer has to pay \$30,000 to \$35,000 a year in premiums, for additional savings. In turn, the cash can be used for anything

Many consumers lose tens of thousands of dollars by 'surrendering' their policies rather than opting for life settlements

— for example, a long-term care policy, investments, an indulgence, or even for a gift to the original beneficiaries. Here are some case examples:

A Pennsylvania man, 69, in poor health, had a \$500,000 term policy



Policyholders can now get large sums of money for expenses like long-term care.

whose premiums he could no longer afford. Although settlements with term policies are rare, in this case he received a lump sum of \$100,000, and used the proceeds for long-term care needs.

Also, a 72-year-old widow in Alabama, facing rising premiums, received 2.5 times the surrender value. She said, "If I had let the policy lapse I would have walked away with nothing, after all those years of paying premiums."

The estimated \$13 billion life settlements industry is expected to grow to \$150 billion by 2015, based on studies by Bernstein Research, the Katt Group and ABN-AMBRO Bank. The Wharton Business School of the University of Pennsylvania and Conning and Co. Research, estimate life settlements will lead to billions of dollars in "surplus" benefits to insureds that exercise the

option to sell their policies at a competitive rate. Note that with about \$9 trillion of life insurance in force, the potential for growth is enormous.

Attorney David M. Lewis, testifying before a House Committee on Financial Services, says: "A life settlement gives policy holders a new option to consider in their financial planning." Life settlements have created a secondary market for insurance policies. Warren Buffett is reportedly a proponent of life settlements.

Who loses?

Obviously, the original beneficiaries. But the big loser is the life insurance company, which previously could look forward to high lapse rates, but must pay the full face value to the new institutional owners when the former policyholder dies. With some exceptions, life insurance companies are strenuously fighting the life settlement trend. But a handful of insurers are participating to hedge their risk, and other insurers, of the property and casualty stripe, actively engage in arranging life settlements.

A Netherlands-based global banking concern, in an internal report, estimated that investment returns may range from 8 percent when the insured lives about 10 percent longer than expected, to more than 12 percent when the insured lives about 10 percent shorter than the projected expectancy.

The insureds are not "babes in the wood," waiting to be exploited. "Typically," explains Brian D. Pardo, head of Life Partners Inc. of Waco, Texas, a pioneer of life settlements, "the senior is affluent, not hard pressed, accomplished and financially sophisticated." He advocates, "Never let the policy just lapse — don't ignore the real value of what actually is an asset, to the policy holder."