

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."

The executive director of the Orlando, Fla.-based Life Insurance Settlement Association, Doug Head, advises seniors contemplating the sale to obtain bids in writing and to ask for full disclosure from providers.

Jordana Balsam of Balsam Settlement Management in New York, counsels seniors to ask for references and to be sure that a provider has a license to do business in their state.

Estimates indicate there are about a dozen well-established providers in the field, and 20 or so smaller players. The former include Peachtree Funding, Atlanta Ga.; Maple Life Financial, Bethesda, Md.; Life Partners, Inc., Waco Texas; and Coventry First, Fort Washington, Pa.

Coventry's CEO, as reported in *The Wall Street Journal*, suggests that providers pay from four to eight times the surrender value, but Pardo of Life Partners says that figure is on the conservative side, and that "payments are typically higher, depending on age and other factors." How would a senior proceed to look into life settlements?

One route is by contacting providers directly. Another is to use intermediaries, such as financial advisors and planners, independent insurance agents, (company agents dare not even suggest the life settlements option), elder law, and trust and estates lawyers, investment counselors, and CPAs.

There are several hundred of these professionals familiar with life settlements, and their ranks are growing.

Intermediaries receive commissions of 3 percent to 6 percent from the providers, and nothing from the selling insureds. One independent agent disclosed that in addition to the commission he received for helping arrange a settlement for a client, he sold the client a needed long-term care policy.

A caveat for seniors: If a provider deliberately overestimates the expected remaining life expectancy, the insured will receive less. To counter this, the owner should shop the policy before accepting a bid.

The bottom line: If life settlements were not a beneficial option for seniors, how could their rapid growth — and the resistance of major life companies to the concept — be explained? **NM**

Adjustable Mortgages Set Up Homeowners for a Fall

by Jean Pearce

When they signed on the bottom line, the idea that their interest rates would rise with the market didn't faze consumers who opted for adjustable rate mortgages.

With the keys to their new home within reach across the table, a future hike of 1 or 2 percentage points probably didn't sound like a lot to those who didn't do their homework.

That's the central, dangerous principle of ARMs. You get a lower rate up front, but you take the risk that interest rates may go so high that you're priced out of your home.

Thousands across the country are locked into ARMs as the Fed continues its headlong assault on low interest rates. For many consumers, their ARM has become a trap.

On a \$100,000 mortgage, a rise of 2 percentage points can take a monthly mortgage payment from \$780 to \$1,600. The results can be devastating as consumers struggle to avoid foreclosures, say experts with the Consumer Federation of America (CFA), a non-profit consumer advocacy group.

The problem is exacerbated by consumer ignorance. According to a study conducted by the Federal Reserve in January, 41 percent of homeowners with ARMs didn't know the maximum interest rate they could be charged, and 17 percent didn't know how often their monthly payments could rise.

Despite the shortcomings of ARMs,

they're becoming increasingly popular, in part because they help buyers purchase more expensive homes than they normally would be able to afford using a 30-year fixed-rate mortgage.

Just four years ago, fewer than 7 percent of borrowers took out ARM loans. Now, about a third do, according to a report in *The Washington Post*.

For savvy mortgage shoppers, ARMs aren't necessarily a bad thing. Some ARMs cap interest hikes at 2 percentage points annually and 5 percentage points for the life of the mortgage.

As long as you understand the terms, an ARM can make sense financially — particularly if you buy in a rapidly appreciating area and you only plan to own the property for a few years, advises Kyle Killian, owner of the Killian Mortgage Co. of Charlotte, N.C.

"An ARM can keep your payments down and give you better monthly cash flow in the short term," Killian says. "If you're buying a home for the long term, my advice would be to go with a 30-year fixed-rate mortgage."

Federal law requires lenders to disclose in the loan documents how high and how fast your rate can climb, Killian said. Reading those documents — and understanding them — is critical before you sign on the dotted line.

"The bad news," says CFA Executive Director Stephen Brobeck, "is that lower-income and minority Americans are not only those most likely to prefer ARMs, but they're also those with the poorest understanding of the risks." **NM**

