April 2002 The Magazine for Top Life, Health, and Financial Services Producers

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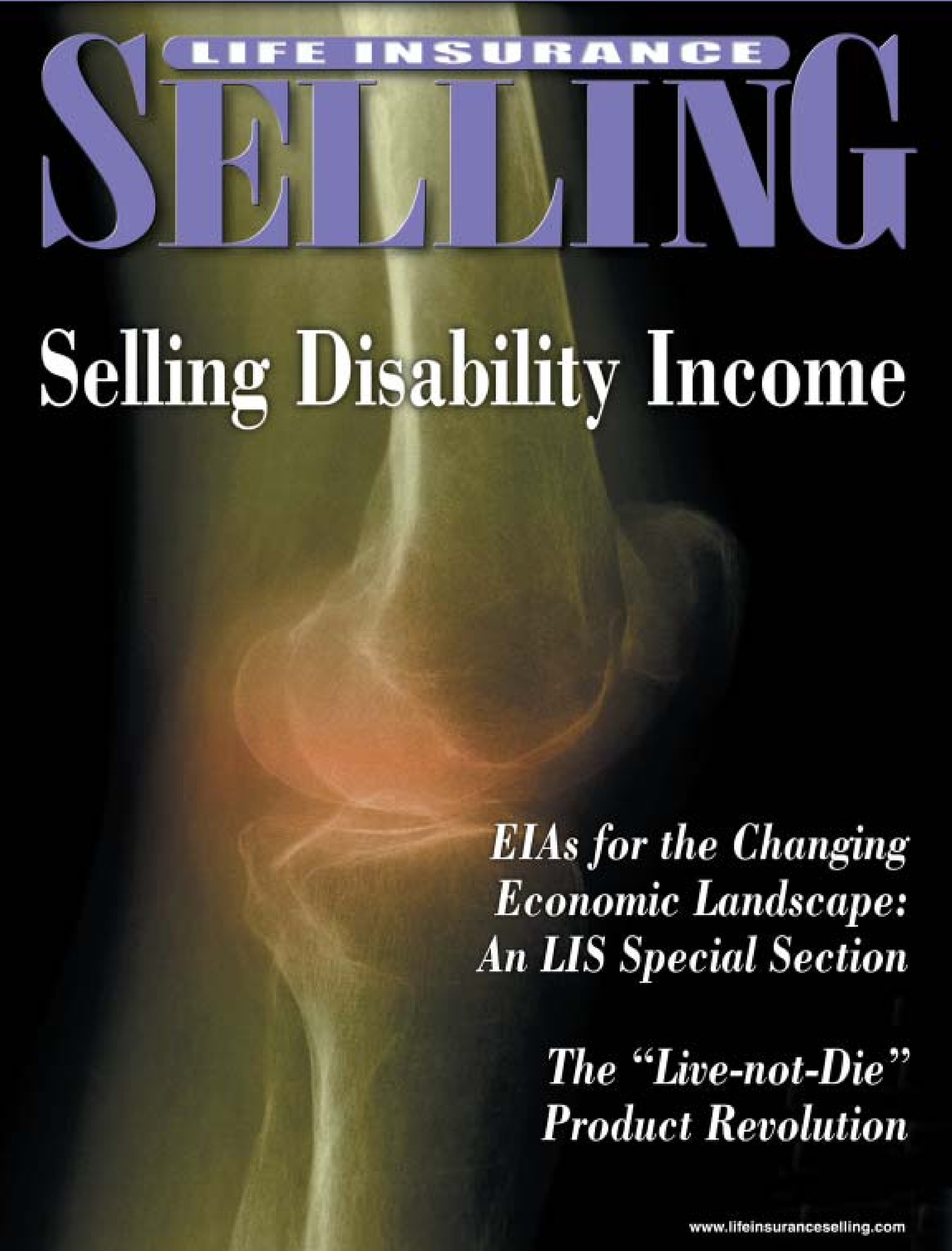

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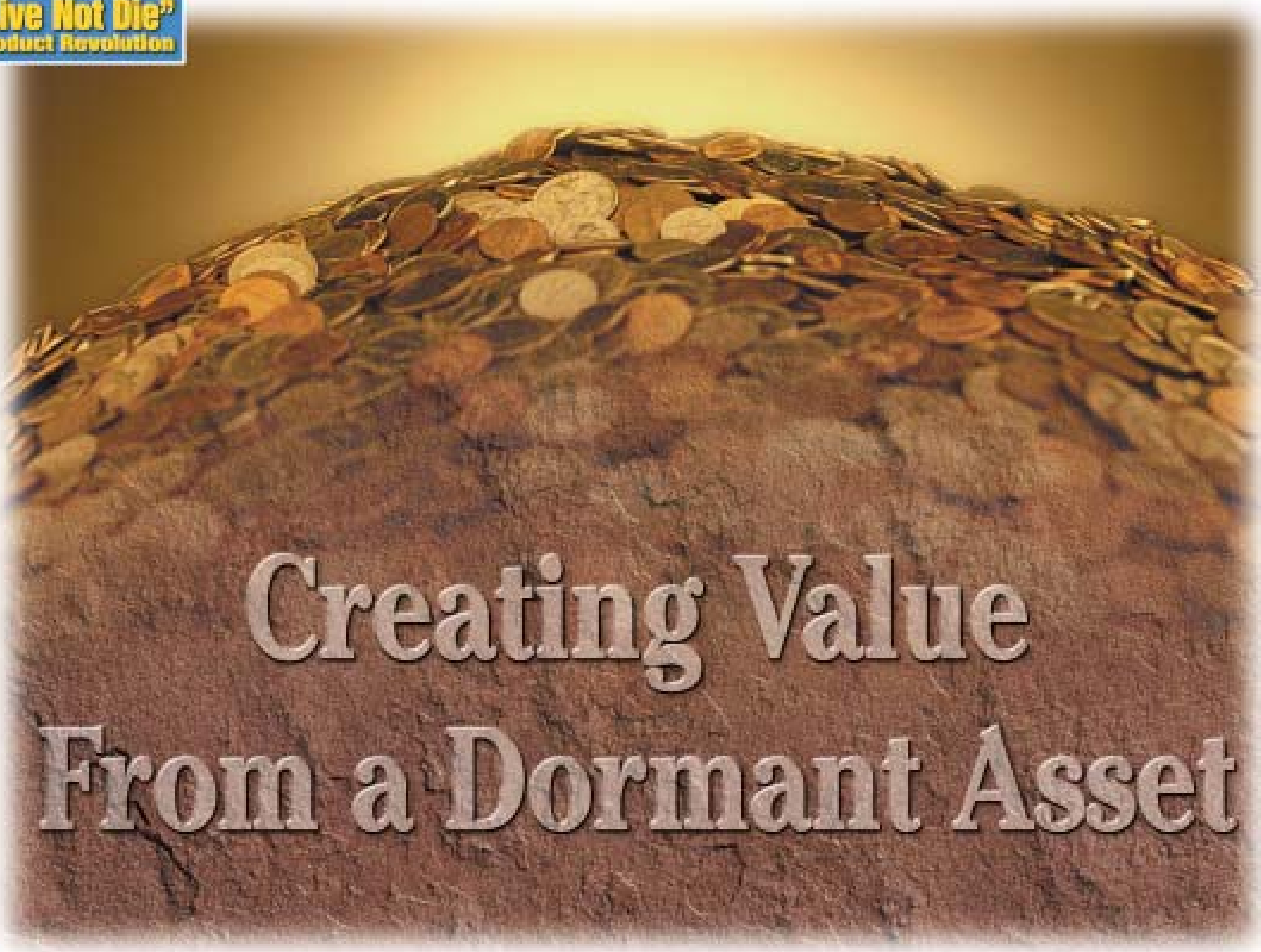

Creating Value From a Dormant Asset

By Michael Krasnerman
allSettled Group Inc. • New York

A quiet evolution in the life insurance market has caused some life policies to be worth a significant amount over the cash surrender value in many situations. Even a straight term life policy may be worth a significant amount of cash!

Financial professionals, whose clients often carry high-face-value policies, should know how to access that insurance's real market value. Otherwise, they may be overlooking an asset that can be turned into a substantial amount of cash.

A senior settlement enables individuals, businesses, and other organizations to sell existing life insurance policies, and receive a cash payment exceeding the policy's surrender value.

> *"... a major transformation of the senior settlement business will take place within the next few years."*

According to a December 1999 report by Conning and Co., more than 20% of life insurance policies on individuals 65 and older have a fair market value greater than the cash surrender value. In other words, there is $108 billion of insurance in force on insureds over age 65 that may qualify for a life settlement. This includes term, universal life, whole life, and survivorship policies.

This translates into $43 billion of term insurance and $65 billion of permanent insurance in force for insureds over age 65 that may be worth more than the cash surrender value available to the client.

In recent years, Wall Street investors' increased interest in life settlements has led to an influx of capital into the market. According to the Conning study, $1 billion of death benefit was purchased in 2001. This number is expected to increase — estimates show that the annual amount of policies purchased could go as high as $10 billion.

How much could a policy be worth? The amount of money the policyholder receives for the policy is calculated based on the age and relative health of

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I/R Code: 8350 Viatical Settlements

the insured, as well as the policy's costs, duration, and cash surrender value. Most clients have experienced a decline in their health status since the policy was issued. Each transaction is evaluated individually. Here are some examples to illustrate the range of possibilities.

Example 1:

Universal Life
Face amount: $450,000
Cash value: $0
Male insured age: 68
Client sold policy for: $70,000.

A mid-sized manufacturer was operating in Chapter 11 bankruptcy. As part of the process of submitting operating reports, the consultant decided to confirm the key-person insurance policy's cash surrender value. He learned the policy had been fully borrowed against and management was ready to terminate the policy because the large annual premium was coming due.

The consultant remembered a senior settlements ad in an industry publication. The curious consultant contacted the purchasing company. At the time of review the insured was a 68-year-old whose health status had declined slightly since the policy was issued. The policy had no cash surrender value. The $450,000 policy was sold for $70,000.

Example 2:

Whole Life
Face amount: $8 million
Cash value: $795,000
Male insured age: 76
Client sold policy for $2.3 million.

Because of a family conflict, the insured wanted to surrender his $8 million whole life policy and invest the $795,000 of cash value. The insured's producer was not aware of the opportunity to sell the policy and did not suggest senior settlement as an option. The insured consulted his attorney for a second opinion. The attorney referred the insured to a life producer who actively is involved with senior settlements.

The insured was underwritten for a senior settlement. The client received $2.3 million for his policy, $1.5 million over its cash surrender value. The producer received compensation for the senior settlement and additional referrals.

Six months later, the insured asked the same producer to write him a new policy to satisfy his divorce settlement with a total face value of $5 million. The new policy was issued as substandard with an annual premium of $376,000. The insured made a single premium deposit of $1 million into a universal life contract with a projected annual premium of $150,000 a year.

According to this producer, since becoming involved with senior settlements, his income has quadrupled and he made more than $2 million in 2001.

Example 3:

Term
Face amount: $3 million
Cash value: $0
Male insured age: 75
Client sold policy for $930,000.

The insured had a $3 million term insurance policy that had been taken out three years prior to cover a loan for his company. Because of a change in his health, the business was sold and the loan was repaid. There no longer was a need for the term policy.

The insured met with his producer who suggested that rather than letting the policy lapse and receiving nothing for it, there was a new option. He could sell his policy and obtain value where none existed before.

The insured sold his term insurance policy through a senior settlement and received $930,000. The producer received compensation for the senior settlement and a commission on the $3 million term conversion.

A financial professional is in a position to structure a sale that best meets his clients' objectives, and to outline the various benefits and settlement options. While each person's needs are unique, the following examples highlight some situations that might lead to recommending a senior settlement transaction.

Senior Settlements in Business Situations

Senior settlements can be useful in many business situations:

Mergers and Acquisitions

• A policy to finance a buy/sell agreement isn't needed after the business is sold to a third party.

• Because of an ownership change, a key-person policy no longer is needed.

Business-Owned Life Insurance

• A business owns a key-person policy on a former executive.

• A company owns policies bought to fund deferred compensation or retiree benefit programs after such programs have been changed.

• A business is sold and insureds retire. Buy-sell funding isn't needed.

• There is unwinding of the split dollar plan because of bankruptcy or employment termination.

Senior Settlements in Estate Planning Applications

Senior settlements also have estate planning applications:

• A reduction in a client's estate size or a change in tax policy means less insurance is needed to pay projected estate taxes.

• A client's financial condition changes and he or she can't afford the premium.

• A client outlives his or her family or beneficiaries.

• An increase in a client's liquidity makes life insurance a less desirable funding mechanism to pay estate taxes.

• A policy gifted to a not-for-profit organization can be sold by the organization to supplement cash flow.

If the producer considers which of his clients might be a senior settlement prospect, he will see the huge need for senior settlements in the growing group of retired people in their senior years.

Clients whose circumstances have changed so the need for their insurance is gone and whose insurability has changed since the policy was issued are ideal senior settlement candidates. Such situations as business changes, company solvency issues, estate changes, and poorly performing policies create the need for a senior settlement.

To qualify for a senior settlement, a case must meet the following profile requirements:

• An insured who is 65 or older.

• Policy face amount: $100,000 minimum.

• Life expectancy: 14 years or less.

• A change in insurability since issue.

• Any kind of insurance policy (i.e. universal life, whole life, term, survivorship).

• A lower cost to carry the policy is more attractive.

• Annual premium usually can't exceed 5% of face value.

Our Opinion

Life insurance became a commodity long before the senior settlement business evolved. An enormous stock of about $12 trillion of face value of an illiquid investment held by millions of people will become liquid.

The senior settlement business is in the infant stages. Life insurance producers, estate planners, attorneys, and accountants should realize that they are responsible for informing their clients about this new option.

Seniors sell such assets as homes, boats, jewelry, stocks, and bonds to meet their changing needs. The producer might ask himself, "Why wouldn't seniors sell their life insurance policy?" The answer is simple: They would!

Life insurance producers are trained to sell insurance for life insurance companies that offer competitive pricing, underwriting expertise, training, and marketing support. The purchasing companies must follow the same model. The purchasing company should offer fair and competitive purchasing parameters, expertise in reverse underwriting and insurance premium calculations, and comprehensive knowledge of actuarial tables and assumptions. The senior settlement companies must provide training and marketing support. They also should conduct their business in an ethical and responsible manner.

A major transformation of the senior settlement business within the next few years will bring phenomenal growth and an enormous money making opportunity for life insurance professionals who embrace this new business.