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## **New Trend In Cashing In Key-Person Policies: Life Settlements**

By Larry Simon, president and founder, Life Settlement Solutions, Inc.

For many small and medium-sized businesses, there is one person crucial to the organization—the one whose absence would sink the company. To protect the company should this executive prematurely die, retire or suddenly leave the organization, companies frequently purchase “key-person” policies, which safeguard the human and financial assets of a business.

In the past, when an insured key person retired or resigned, the company typically canceled its corporate-owned policy and took the cash surrender value, if any was remaining. Life settlements (also known as high-worth transactions) offer the company a new, viable and attractive option: sell the policy, be rid of any future premium obligation and receive a lump sum of cash well above the cash-surrender value.

### **Secondary Market Allows Key-Person Policies to Generate Cash**

Life settlements can assist companies in dealing with several possible scenarios. In some cases, a key employee will retire and the company may offer to transfer ownership of the key-person policy to the retiree. Such an offer is often declined, because the retiree does not need the policy or the obligation of making high premium payments. There may also come a time when the key-person policy is no longer needed: the key executive may become less critical to the business because the aptitudes of other executives have improved or the business is sold.

When a business merges with another, or is acquired by another, key-person policies often become assets of the new entity. Key executives of the acquired business may not be key executives in the new business. In the past, companies facing these situations were left with three choices, depending on the type of policy:

- 1) recover some of the investment and surrender the policy for its cash value;
- 2) allow it to lapse, and write off years of premium payments as a necessary but unrecoverable business cost;
- or
- 3) continue to pay premiums on the policy until the death of the insured person.

A better alternative for the company is to investigate the advantages of selling the policy through a life settlement broker. If it is a policy with cash value, it may be likely that the sale will provide more than the cash value. If it is a term policy, the policy can still be sold, and funds can be obtained from a policy that previously had no intrinsic value.

### **How Life Settlements Work**

Life settlements are based on the proposition that some insured individuals no longer want, need or can afford their coverage. Instead of selling the policy back to the issuing insurance company at less than market value, or allowing the policy to lapse and forfeiting the value, life settlements allow another exit option that can maximize the cash value for the policy owner. Consequently, life settlements have quickly developed into a viable and attractive alternative product. In a nutshell, the life settlement process works like this: a life insurance policyholder sells the benefits of the policy to an investor. Most investors do not directly negotiate with policyholders; rather, they provide financing for life settlement companies that facilitate the buying of the policies. According to a June 5, 2003 article in USA Today (“CEO life insurance as an investment?”), approximately 25 percent of key-person policies can be sold to institutional investors in the secondary market.

Policies considered for purchase by life settlement companies must meet certain eligibility requirements. Typical criteria formed with the life settlement companies or investors are as follows:

- The policy must be beyond any carrier or statutory contestability period, fully renewable, and subject only to the payment of premiums;
- The insured's life expectancy must be between 25 and 144 months based on one or more medical evaluations from

- an approved evaluator;
- Term policies must have a minimum term life insurance coverage equal to the greater of two times the life expectancy, or 10 years; and
- The face value of such policy cannot exceed \$20 million.

If the company accepts the life settlement company's offer, it relinquishes ownership and beneficial interest in the policy in exchange for a cash payment. As the new policyholder, the investor must maintain all premium payments in order to keep the policy in force. The concept is much like the buying and selling of mortgage contracts – in this instance an insurance contract is bought and sold with the investor acquiring both the beneficial interest in the contract and the obligation to provide for servicing and administration of the contract.

The market opportunity exists primarily as an alternative to surrender values payable by life insurance companies when a policy owner decides to redeem or cash in the policy. These surrender values are often so low that a qualified life settlement provider company can pay a higher value. Finding the Right Life Settlement Company

Policy owners should insist their agents and brokers perform due diligence by gathering information from several competitive life settlement companies, targeting those whose senior management has had the most life settlement experience. A German company known as Scope Group has become active in rating and ranking life settlement companies, so far the first and only company to do so. Scope offers information on its Web site at [www.scope-group.com](http://www.scope-group.com). The settlement broker or agent should seek companies with an A-rating or higher.

### **A Rapidly Growing Industry**

The future looks good for the life settlement industry, which has grown significantly in recent years. Life Settlement Institute released statistics in April 2005, indicating life settlements have paid life insurance policy owners an aggregate of more than \$1 billion over cash surrender for their policies.

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Larry Simon is director, chief executive officer and president of Life Settlement Solutions, Inc., based in San Diego, Calif. Life Settlement Solutions and its management have an established, proven industry record, having purchased life insurance policies in excess of \$1 billion aggregate face value to date. For further information regarding Life Settlement Solutions, call 858/576-8067 or visit [www.lss-corp.com](http://www.lss-corp.com).