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Term life insurance policies marketable

BY JEFFREY R LEE

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Richard Roto hates the estate tax. Seventy-six years old and owner of Roto Mercury Lincoln Subaru Mazda Inc., in Arlington Heights, he had paid tens of thousands of dollars in annual life insurance premiums on policies that would pay his estate taxes. So when Congress passed a law phasing out the estate tax, Roto was enthusiastic. He was even happier when he found out he could get cash for the life policies he no longer needed, a transaction called a life settlement. "What a pleasant surprise when I heard of life settlements," he said. "I had no idea that someone would buy the policy and pick up the premium. It's a hell of a deal."

After shopping around, Roto's agent found a buyer who would pay $36,500 for a $400,000 term life policy Roto had owned for years.

Roto is just one of the sellers in a market that is growing by leaps and bounds. Life settlements have become increasingly popular among consumers and some financial planners because they allow people to treat even term life insurance policies as a marketable asset. In a life settlement transaction, the policyholder sells his or her life insurance policy to an investor for more than the cash surrender value but less than the face value. The investor continues to pay the premiums on the policy, collecting the payout when the insured dies.

Larry Simon, president and CEO of San Diego-based Life Settlement Solutions Inc., says he expects more than $12 billion in death benefits to be sold this year, up from $8 billion last year. The Viatical and Life Settlement Association of America (VLSAA) lists 25 member brokerage firms and 26 providers on its Web site, including two in Illinois. The only thing limiting the industry from growing even faster is the number of policies on the market, says Sean McNealy, president of Orlando-based brokerage firm Advanced Settlements Inc.

"It's a real seller's market," he says. "There's more money than inventory."

The life settlement industry grew out of a market for insurance transactions called viatical settlements that was born during the 1980s HIV/AIDS epidemic. Originally started as a way for terminally ill patients to pay their bills in their final years of life, the market attracted some unsavory characters and all but vanished, according to people in the business.

In 1999, Simon was one of the first in the business to offer an alternative to the viatical settlement. Whereas viatical settlements were made with people with a life expectancy of less than two years, life settlements are made with people who have no catastrophic illness and are expected to live anywhere from two to 12 years, Customers usually have a high net worth and life policies with benefits of $500,000 or more. Often their needs have changed, and for whatever reason they no longer need as much insurance. Life settlements provide a way for the customer to dispose of unwanted policies for their market value.

"An insurance company can't add value to your policy for a shortened life expectancy," Simon says. "Life settlements can pay you what it's truly worth."

The market for life settlements has yet to grow much in Illinois simply because the population of affluent senior citizens is smaller than in states like Florida, Arizona or California, says Leon Benkovitz, vice president of Lincolnwood-based life settlement provider Neuma Inc. In Florida, some providers are even advertising with infomercials, he says, while life settlement advertising is much more rare in Illinois.

"People are not that educated about it here," he says.

Despite the lack of advertising in some areas, several trends have driven the market's recent growth. The population is simply getting older, meaning more life insurance policies are in force. The change in estate tax laws has spurred many policyholders to dump their excess protection. Congress passed a law in 2001 increasing the estate tax exemption and gradually lowering the tax rate until 2010, when the tax will be completely repealed, but for just one year. Unless Congress enacts a permanent repeal of the tax, as President Bush proposes, it will revert in 2011 to its original levels.

Furthermore, many consumers are using life settlements to trade their policies for a bigger, better or cheaper one.

"It's like 'buying up' in cars, except with life insurance," says M. Bryan Freeman, president of the VLSAA. Policyholders will usually appraise the type of insurance deal they could get in the marketplace before making a settlement.

With more money than insurance in the market, some companies are manufacturing opportunities to make settlements. In a practice called non-recourse premium financing, a lender loans money to a customer for two years to purchase a life insurance policy. After two years, the customer can then keep the policy and pay back the loan with interest, or sell it to a life settlement provider to pay off the loan, or simply transfer the policy to the lender to satisfy the loan. Some lenders even go so far as to pay the customer a signing bonus for taking the policy. Those deals are usually good for consumers, but it's a questionable practice, and insurance companies hate it because policies purchased by investors never lapse, says Byron Udell, founder and CEO of Wheeling, Ill.- based insurance brokerage Byron Udell & Associates, Inc., which does business as AccuQuote. "Life insurance companies anticipate lapses because they're profitable to the company," he says. "Insurance prices would be a lot higher if no policies ever lapsed."

But the number of policies eligible for life settlements is so small that it could not affect pricing, argues John Skar, senior vice president and chief actuary at Springfield, Mass.-based Massachusetts Mutual Life Insurance Co.

Rather than saying customers should let their policies lapse, he says customers should keep their policies, pointing to a study funded by MassMutual and conducted by New York-based Deloitte Consulting LLP. That study, which analyzed New York life settlement sales from 2000 to 2003, found that while, on average, the "intrinsic economic value" value of policies was 64 percent of the face amount, settlements paid out only 20 percent, meaning the rest was lost to transaction costs and profit. The intrinsic value is defined as the "actuarial present value" of future benefits minus the APV of future premiums.

"The first question you should ask yourself is, 'Do I have an estate plan?'" Skar says. "If the answer is no, then maybe think about a life settlement.

But I don't think there are many people in that situation."

Skar says that if a policyholder has any estate plan, he or she should sell any other assets before destroying the value of the insurance policy.

The VLSAA said the Deloitte study was flawed because New York regulates and collects data only on viatical settlements, not life settlements, and did not touch on the practice of using a settlement to purchase a new policy.

The life settlement market could actually improve business for the life insurance industry, says Rob Haynie, managing director of Life Insurance Settlements Inc., in Fort Lauderdale, by giving consumers an incentive to buy insurance.

"Over time carriers will realize that the presence of a secondary market will improve people's reasoning to buy a policy in the first place," he says.

Financial planners are divided about life settlements. Though Jeffrey Cribbs, a planner in Oak Park, said a settlement might be useful in the case of some clients, he points out that investors are interested in life insurance policies because they do build value.

"People in this market are hard-pressed to find advice they can trust," he adds.