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Offices in
Portsmouth and
Virginia Beach, Virginia
Tel: 757-399-7506
Fax: 757-397-1267
Web: www.oasthook.com

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Editor
Sandra L. Smith
Attorney at Law

LIFE SETTLEMENTS – FINDING HIDDEN VALUE IN YOUR FINANCIAL STATEMENT

BY

RICHARD E. NOTTINGHAM

A life settlement is a transaction involving the sale of an existing life insurance policy by the policy owner to a life settlement company. The result of this strategy can net the policy owner a sum many times greater than the policy's cash value and provide the policy owner substantially more than the total premiums paid for the policy since its inception.

Until recently, a policy owner who no longer needed a life insurance policy, or who could no longer afford the premiums, had no choice but to surrender the policy to the issuing insurance company for its cash value, or in the case of term insurance, to simply let the policy lapse. The inception of the life settlement industry, however, has created a new option for policy owners, often with favorable results.

Who is eligible to benefit from life settlement transactions? Life settlement companies buy policies with the intention of paying premiums until the death of the insured, then collecting the death benefit. Generally, these companies will purchase policies that insure persons with life expectancy of up to 15 years, and with policy face amounts of $250,000 and greater. Therefore, seniors age 65 years and older, even if their health is good, may be excellent candidates to benefit from a sale of their life insurance.

Why might a senior citizen want to sell a policy? First, because the policy is no longer needed. Examples of this circumstance are numerous. A husband may have maintained a life insurance policy to provide cash to his wife upon his death, but now his wife has predeceased him. Or, the coverage may have existed to fund a business-related need such as a buy-sell agreement, and now the insured has sold his interest in the company and retired. Perhaps the policy was intended to pay federal estate taxes upon the death of the insured, but changes in the tax laws or changes in the estate planning goals of the insured now make the policy unnecessary. Many seniors today have no estate tax liability, whereas several years ago their heirs would have faced a significant estate tax obligation.

Second, because the policy is no longer affordable. Frequently, policy owners today are faced with premiums much larger than when they purchased the coverage. This is true with term insurance, since premiums escalate drastically in the later years of the insured's life. Or, many seniors are insured with interest-sensitive whole life or universal life policies requiring much higher premiums to maintain them than were originally projected when the policies were purchased years ago in a higher interest rate environment. Further, many seniors have smaller incomes than during their working years, or they must redirect some of their income to meet medical or long-term care expenses.

Third, when the policy owner is dissatisfied with the existing policy's performance and wants to replace it with a better policy. In recent years, the cost of newly issued policies has dropped significantly, due to longer life expectancies. A healthy 75-year-old can purchase new coverage today for less money than when he or she was age 60. Newer policies typically provide better guarantees and more favorable provisions than were previously available. Thus, many seniors are replacing old policies with new ones, with lower premiums as a result. Rather than cashing in the old policy, a sale of the old policy to a life settlement company can produce a better result.

What are some examples of life settlement results? A 70-year-old healthy widower sold a $500,000 policy for $70,000. If he had cashed in the policy, he would have received only $27,000. His result was a $43,000 profit. In another example, a 77-year-old-man sold his $500,000 policy for $97,000. The policy's cash surrender value was only $6,000. Thus, he received $91,000 more as a result of the life insurance settlement than he would have netted by simply surrendering the policy. In a third example, an 85-year-old widow sold her $5,000,000 policy and received $1,630,000. The policy's surrender value was only $141,000, so her life settlement netted an improvement to her of $1,489,000. She used the proceeds to acquire a $5,000,000 policy with a premium of $52,000 per year less than the policy she sold.

These are three outcomes of successful life settlement transactions. By the end of 2004, life insurance policy owners who sold their policies to life settlement companies received more than $1 billion in excess of the cash surrender values of these contracts. Articles describing the benefits of life settlements to policy owners have appeared in publications such as *The Wall Street Journal*, *Trusts & Estates*, *The Journal of Accountancy*, and *The Journal of Financial Service Professionals*.

How can policy owners determine whether a life settlement is appropriate for them? According to author Alan H. Buerger in an article in *Trusts & Estates*, "There is a new reality to life insurance policy ownership, and all clients age 65 or older should have their policies appraised." With respect to life settlements, appraisal refers to the process of determining what a life settlement company will pay for a policy. This appraisal costs the policy owner nothing, and it does not obligate the policy owner to sell the insurance unless the policy owner chooses to do so. It only involves giving the life settlement company the right to review the insured's medical history, and to learn details about the insurance policy being considered for purchase. No medical exam is required. In order to maximize the offering price, however, it is essential to have the policy appraised by numerous life settlement companies in order to create a competitive bidding environment.

What options exist for a policy owner after the appraisal process is complete? If an offer is made to purchase the policy, the policy owner can accept it or reject it. If accepted, the proceeds from the sale can be used by the policy owner as the owner chooses. Often the proceeds are reinvested, used to meet costs associated with long-term care, gifted to family members or charities, or used to acquire new life insurance or long-term care insurance.

Before deciding to accept a life settlement offer, the policy owner should seek both legal and tax advice from an attorney and a certified public accountant. Tax consequences of life settlements are quite favorable, and often little or no income tax is due on the amount received. However, the opinions of these legal and financial professionals are important to be sure the transaction is in the best interests of the policy owner and the policy's beneficiaries.

In Virginia, it is also necessary to involve the expertise of someone who is licensed to broker life settlement transactions. Oast & Hook, P.C., has the experience and expertise to assist you with the entire life settlement process.

About the Author

Richard E. Nottingham is president of Cape Financial Inc. A graduate of Old Dominion University with a Bachelor of Science degree in business administration, Mr. Nottingham has earned the professional designations of Chartered Life Underwriter, Chartered Financial Consultant and Accredited Estate Planner. Mr. Nottingham has been an instructor for the Life Underwriters Training Council and the Society of Financial Services Professionals. He is a Registered Representative and an Investment Advisory Representative offering securities and advisory services through Jefferson Pilot Securities Corporation, Member SIPC. Cape Financial Inc. is not affiliated with Jefferson Pilot Securities Corporation.

Announcement

Oast & Hook is pleased to announce that Sandra Smith was quoted in the September 13th edition of the *Virginian Pilot* in an article entitled "New state law gives teeth to pet inheritances." The reporter from the *Virginian Pilot* based her article on the June 30, 2006 issue of the *Elder Law News* on Pet Trusts. To read the complete article visit their website at
http://home.hamptonroads.com/stories/story.cfm?story=110915&ran=240653.