

What is a Life Settlement?

A Life Settlement is the sale of an unwanted life insurance policy for a lump sum of cash. The amount received can be greater than would be received by surrendering the policy to the insurance provider. Life Settlements are also referred to as Senior Settlements.

History

The legal basis is found in the United States Supreme Court decision; Grigsby vs Russell, 222 US 149 (1911). This was a unanimous decision written by Chief Justice Oliver Wendell Holmes. The decision affirmed the basic rights of ownership of life insurance policies.

The right to:

- Name a beneficiary
- Change a beneficiary
- Use the policy as collateral for a loan
- Sell the policy

Why Would Anyone Sell Their Policy?

Most people simply no longer have a need for the coverage or can no longer afford the premium payments. The purpose for which it was purchased no longer exists.

Other reasons may be:

- Insured's estate has been reduced to a point that the tax burden no longer requires coverage to pay the estate tax.
- Spouse/primary beneficiary has died.
- Policy owner is in the process of or has gone through a divorce. (In the past, the only policies that were considered of value as a marital asset were those with cash value. Now term insurance, which has no cash value component, may have a value.)
- Policy Owner is in the process of or has gone through a personal or business bankruptcy.
- Buy-Sell or Key Man policy is no longer needed due to retirement or death of a partner or the company no longer exists.
- Universal Life Policy that was supposed to fund itself – sometimes referred to as a disappearing premium – isn't performing as expected and now significant premiums are required to keep the policy in force.
- Split-Dollar policy on a key employee has been challenged or disallowed by the IRS.

What Can The Proceeds Be Used For?

Whatever the policy owner finds of value, including Charitable Gifts that can be made while the owner is alive to see the money put to use.

Instead of simply surrendering the policy to the insurance company, the policy owner may be able to sell it for much more in the secondary market. In the case of term insurance which has no cash value, therefore, no surrender value, now there maybe value where before there was none.

The Life Settlement Industry has created a secondary market and therefore competition for policies. Many of the institutional investors who purchase these policies are, in fact, insurance companies along with pension funds, hedge funds, etc. Surrendering a policy for the cash surrender value is, in effect, the same as selling the policy back to the issuing insurance company.

How Do Life Settlements Work?

A Life Settlement is the sale of an existing life insurance policy to a third party settlement provider. The proceeds of the sale will come in a lump sum of cash and usually are more than the cash surrender value, but less than the face value/death benefit of the policy. The settlement provider becomes the owner and beneficiary of the policy and takes over the obligation for payment of future premiums.

What Are The Requirements Necessary to Sell the Policy?

- The insured must be at least 68 years old (could be younger if there are health issues involved).
- Minimum policy size of \$100,000 – no maximum.
- Policy must be at least 2 years old.
- The insurance company must be rated A or better by AM Best.
- Term, Whole Life, Universal Life, and Variable Universal Life are acceptable types of insurance.

Are there tax consequences for the seller of the policy?

Anyone considering a life settlement should consult their legal counsel or tax advisor.