COMMITTEE REPORT:
INSURANCE

By **Jon B. Mendelsohn**

Life Insurance Triage Tips for Fiduciaries

Help clients evaluate whether it pays to sell a policy through a life settlement

Certain universal life (UL)-based products have been severely impacted by fluctuating interest rates, lack of policy management and insureds living well beyond the original projections. UL insurance was introduced to consumers and advisors in 1979 when interest rates were in the mid-to-high double digits. Most didn't understand that this new form of permanent life insurance shifted performance risk to the policy owner. If interest rates remained high, those policies could build up considerable cash value. However, the unusually high interest rates of the late 1980s plummeted and have hovered between the 3% to 5% range, where they've remained until now. These policies may lack the ongoing funding strategies that can save them from imploding and so are in danger of doing just that. Fiduciaries (that is, a client's advisor, attorney, CPA or trust officer) often aren't aware of these problems within their clients' policies. Here's what they should look out for and how to determine whether they should discuss the option of selling the policy through a life settlement.

Who's Affected?

This insurance blind spot is negatively impacting certain demographics more than others. To illustrate, we pulled a representative sample of 1,000 completed life settlement transactions over the past 17 years and found that 88.89% involved insureds ages 76-100. Additional research revealed that 98% of those policies settled on the secondary market were some form of UL and term insurance. Many of these clients are what's known as "orphaned policy owners," which means that the agent they originally dealt with is no longer servicing the policy. They're usually assigned to new agents who are incentivized to place new coverage and focus on younger insurable prospects. This creates a management void for those policies.

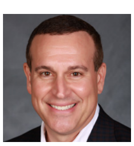
Fiduciaries can take some preliminary steps to identify at-risk clients, starting with asking clients three questions that will help them quickly uncover who may need help:

1. Are you considering lapsing or surrendering your life insurance policy. If so, why? Their answer will help the fiduciary understand their need(s).
2. If yes, is this policy a UL policy?
3. Have you had any changes in health since the policy was issued?

If a client answers "yes" to all three questions, then ask if she's explored traditional non-forfeiture options. If none of those options are acceptable to the client and she plans to let the policy lapse or to surrender it, she may want to consider the option of a life settlement.

Life Settlement Option

There are three ways to sell a policy. The first and most familiar choice is to forfeit/surrender it back to the insurance carrier for the cash surrender value (CSV), a predetermined fixed amount. The second choice is to sell the policy to a buyer who offers more than the CSV, but far less than the fair market value (FMV). In this scenario, the seller considers it a win because she receives more than if she'd just forfeited her policy to the carrier and received the CSV. What she may not understand is that life insurance is an asset, and she may be best served when buyers compete for the right to purchase



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the policy. This leads us to the third and most prudent choice, to engage the services of a life settlement broker/fiduciary to represent the seller's best interests and create a competitive bidding auction to obtain true FMV for the seller. The following example shows how choosing the right value option helps your client and mitigates liability risk for you as the fiduciary.

Example: Your client is an 84-year-old female with a $1.5 million survivorship UL policy with one insured deceased. The carrier purchase price (fixed predetermined CSV) is $25,000. A single buyer/single bid offer from an institutional buyer would yield $75,000.

A broker-negotiated auction offer with 14 incremental bids would yield $475,000 (FMV). See "Policy Auction," this page.

Parties to the Settlement

Similar to any asset sale, the life settlement industry has a buy-side and a sell-side. On the buy-side, a licensed life settlement provider/buyer is a fiduciary to institutional investors who's focused on getting the best deal for them. On the sell-side, a licensed life settlement broker, as the policy owner's representative, acts in a fiduciary capacity for the policy owner and facilitates the negotiations that protect the policy owner's best interests in a life settlement auction. His focus is creating competition among buyers to produce the highest offer to the policy owner.

Vetting Life Settlement Companies

Be sure that the company you choose meets a high standard of independence and expertise by asking these questions:

1. Are you independent, or do you have ownership interests in the fund purchasing the policy?
2. Can you represent and warrant you have all required life settlement licensing to represent the seller?
3. How long have you been acting in the capacity of a life settlement broker?
4. Is life settlement your core line of business? (If it sells financial products or gives financial advice, he could

Policy Auction

Choosing the right option helps your client achieve the best offer

Competitive bidding = fair market value

Death benefit: $1.5 million | Female age 84 | Cash surrender value: $25,000 survivorship universal life | High offer: $475,000

Round		1	2	3	4	5	6	7	8	9	10	11	12	13	14
Buyer 1	Offer	$75K													
Buyer 2	Offer						$275K				$375K				
Buyer 3	Decline														
Buyer 4	Offer		$175K									$400K			
Buyer 5	Offer				$225K									$450K	
Buyer 6	Offer					$250K									**$475K**
Buyer 7	Offer							$300K					$425K		
Buyer 8	Decline														
Buyer 9	Offer			$200K					$325K						
Buyer 10	Decline														
Buyer 11	Decline														
Buyer 12	Offer									$350K					

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have a conflict.)

5. What's your process for managing a competitive policy auction? Please provide a bid history.
6. Do you provide errors and omissions coverage?
7. How do you protect sensitive client information, including cyber issues?
8. How many policies do you review each year in the secondary market? (The more policies the company has reviewed, the more experienced they are in solving complex issues.)

Longevity Crossover Point

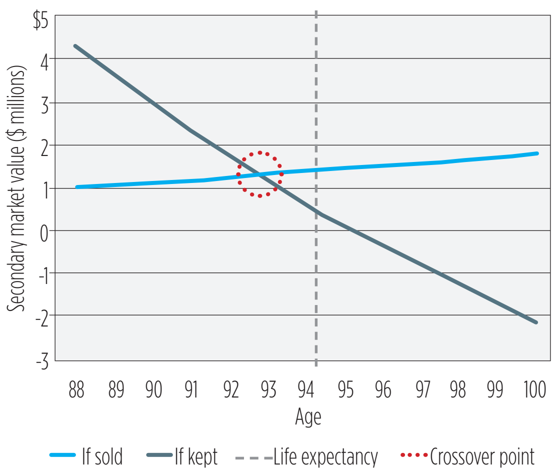
Decisions to keep paying premiums, discontinue premiums or transfer/sell hinge on how long a client has to pay the premium to receive the death benefit. Life insurance can be valued with a market-based methodology in the same manner as other assets like real estate, jewelry, automobiles and fine art. The secondary market valuation (SMV) is a mark-to-market life insurance valuation that determines the present value of life insurance, incorporates individual longevity analytics and complies with the Internal Revenue Service's willing buyer/willing seller definitions of FMV. If your client is living longer than projected, ask questions or propose discussions that will uncover planning needs, such as:

- How do you plan for premium reserves once you're in your late 80s and 90s?
- The premiums become 30% more expensive once you turn 85. That's only a few years away. Let's discuss ways to structure this policy so your family can keep the coverage.
- Your mother is 90 and healthy. This policy matures at age 100. Let's discuss your options.

Discovery of planning needs led to the result outlined in this example: An 88-year-old female had a $5 million UL policy on her life in an irrevocable life insurance trust. It was becoming expensive and difficult to maintain. She wanted to know how much she could

Crossover Point

When to consider a life settlement



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expect to pay and for how long. Should she restructure the policy, and what other options were available? Her family met with their planning team, and they wanted to find a way to provide more certainty when budgeting for her caregiving requirements. She had only age-related health conditions, and her projected life expectancy was age 94 or older. If she discontinued premium payments now, the death benefit would gradually decrease over time. An SMV revealed the crossover point at age 93, when the policy would be worth more if she sold it than it would be if she continued to let the death benefit decline. "Crossover Point," this page, provides a valuable data point for the planning team to make an informed decision about when to consider a life settlement. Even though her life expectancy was age 94 and older, there was a 50% likelihood that she would live longer. The planning team decided to let the death benefit decline until the crossover point (age 93). At that point, they would make the appropriate decision.

Finding the Value

Sort your client files or databases by age, starting with those age 90 and above, then moving to those ages 80-89 and then those ages 70-79. Younger insureds can qualify with a significant change of health since the policy was issued. Once you've identified those clients, take the following steps to gather information necessary to uncover a range of value:

- Appraise all UL and convertible term products owned by your clients who are age 75 and older or by those younger than 75 who've had a health change since the policy was issued.
- Determine if your client is unable to perform any of the activities of daily living.
- Identify any UL policies with clients paying premiums out of cash value.
  Request the following illustrations on UL policies:
  - A zero premium illustration to determine how long the policy will run without additional premiums paid.
  - A current maturity illustration showing the minimum level premium needed to maintain a level death benefit to age 105 and solving for $1 to $1,000 of cash value at age 105.
  - For policies with high cash value, a maturity illustration showing the maximum allowable cash withdrawal, reducing the death benefit by the same amount.

SPOT LIGHT

Heat Wave

Temps Gris À Venise by Albert Marquet sold for GBP 118,750 at Sotheby's Impressionist & Modern Art Day Sale on Feb. 5, 2020 in London. Marquet painted this lagoon during a trip to the Venice Biennale with his wife in the summer of 1936 (his work was the focus of the French Pavilion). A particularly hot summer, the colors chosen by Marquet reflect the hazy conditions.