

LIFE SETTLEMENTS

Keeping a Policy

Research shows that retaining a life insurance policy until death will likely exceed the value of a life settlement.

Insurance and financial advisors now have quantifiable data that illustrates that life settlements may not be an appropriate option for many of their clients.

Recent comprehensive research, sponsored by a group of insurance companies, analyzes the issues arising from the premature sale of life insurance contracts. The research, *The Life Settlements Market—An Actuarial Perspective on Consumer Economic Value*, compares the life settlement value received upon the premature sale of a life insurance policy with the intrinsic economic value of a policy held until death.

What it means

In a life settlement transaction, an existing policyholder transfers ownership of his life insurance policy to an unrelated investor who seeks to receive a high rate of return on his investment upon the policyholder's death. In return, the policyholder receives immediate cash from a life settlement company. When an insured person experiences a negative change in health, the economic value of the policy appreciates, which is why outside investors typically want to acquire the policy.

Destroying estate value

The research indicates that life settlement transaction costs—such as commissions, marketing, overhead and profit—represent 50 percent to 67 percent of the policies' intrinsic economic value.

John Skar, CLU, ChFC, FSA, senior vice president and chief actuary for MassMutual, one of the companies sponsoring the research, believes that this figure helps illustrate the most important point the study makes: "When you sell a life insurance contract, you really are destroying a lot of estate value. The study determined that, on aver-

age, for every dollar you receive in a life settlement offer, you're probably losing between \$1 and \$2 in estate value," says Skar. "If you compare that to the value of any other estate asset, you have a very high transaction cost."

The transaction cost is the reason ad-

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visors need to ask clients who are considering a life settlement a crucial question: Do you have an estate plan or an estate need of any sort? "That's really the key question," says Skar, "and oftentimes that question doesn't get asked. That's the place to start because if the answer is yes, the policy should be retained, and it should be the primary estate asset that you build the rest of the estate plan around.

"If the client needs cash for some other purpose, advisors should look for that cash somewhere else—stocks, bonds, mutual funds—because the life insurance contract is going to cost you too much to liquidate. It absolutely should be the last asset liquidated," Skar says.

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FACTS AND FIGURES**THE LATEST FROM LIMRA**

Individual life insurance sales are off to a sluggish start in 2005, according to LIMRA's *U.S. Individual Life Insurance Sales* (2005, first quarter) report.

- Universal life was the only product to post a gain (2 percent) in the first quarter.
- The sale of UL policies was down 11 percent, compared with sales in the first quarter of 2004.
- The total number of individual life policies sold was down 5 percent, compared with the first three months of 2004.
- Variable life products experienced the biggest declines: Annualized premium and policy count declined 14 percent and 15 percent, respectively.

DISTRIBUTION CHANGES EXPECTED

Significant changes are imminent in insurance distribution that are likely to revolutionize the life insurance business, according to the latest CFO Survey from Towers Perrin.

- 94 percent of survey respondents expect mandated disclosure to the consumer of the relationship between producer and provider.
- 93 percent expect an increase in insurance carrier accountability and liability for the behavior of producers.

TRENDS

A Bright Outlook

Most life insurance salespeople expect a better year in 2005.


With more than half the year gone, many insurance and financial advisors have a fairly good idea of how their 2005 will fare, compared with how they did in 2004. According to LIMRA, which surveyed life insurance producers on their expectations for the coming year, advisors are feeling good.

Regardless of their geographical location or the type of year they had in 2004, a majority of the nation's life insurance agents believe they will do better in 2005, with many expecting to do much better.

The greatest regional optimism is in the South, where 90 percent of producers say they will top their 2004 performance. And even among those agents who described their 2004 as "disappointing," 92 percent see things getting better, with 60 percent declaring that 2005 will be "much better" for them.

In sync

The mood of agents may match that of their potential customers. According to new LIMRA consumer research, 44 percent of American households believe they need more life insurance, and 27 percent of households expect to buy life insurance in the coming year.

Opportunities exist for stronger sales of other insurance products as well. LIMRA's consumer survey showed that many consumers want professional advice on preparing for retirement, insuring against disability and planning for possible long-term care needs. "Needless to say, optimism in and of itself will not create success," says LIMRA's President and CEO Robert A. Kerzner, who spent 20 years in life insurance field sales and management. "If their energy matches their optimism, though, the market seems ready to deliver strong sales." 


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Why is life insurance the most costly to liquidate in this situation? Because it is probably the estate asset that has the highest expected yield. "The people who are buying this policy are probably expecting to make between 9 and 13 percent on their investment," says Skar, "and that's after incurring all costs. If the client is not incurring these costs, what does that imply about his rate of return? His rate of return is probably twice what the investor is expecting, and I don't know where else you can get 18 or 20 percent these days."

An emotional trigger

Skar cautions advisors to be prepared for clients to react emotionally to a life settlement offer. "There's a basic human emotion that makes it difficult for someone to buy life insurance in

the first place, because nobody thinks they're going to die," says Skar. "Flip that around. Someone comes to your client and says, 'How would you like to get rid of this policy? I'll give you money for it.' The emotions that made it so difficult for you to talk that client into buying life in the first place are the same you have to deal with now, because they'll be inclined to bite" at the settlement offer.

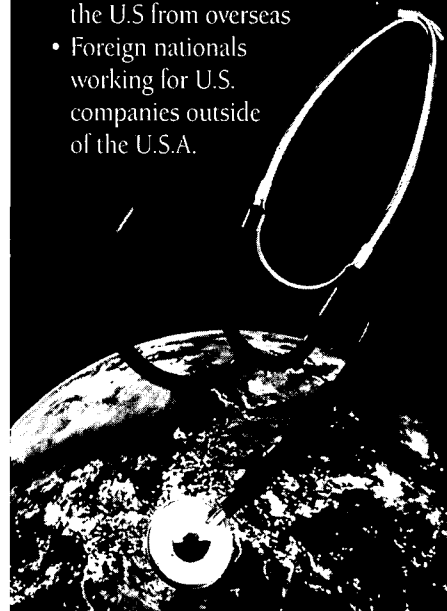
Advisors must point out to clients that keeping their life insurance policies in force is an important component of their estate plans. Choosing a life settlement instead can come with high costs for many clients: disruption of their estate plan as well as considerable transaction costs. 

The full study can be viewed on the internet at www.lifeselementeducation.com.

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