Is a Life Settlement Right for Your Client?

To understand whether or not a client should embark upon a life settlement we must first understand the client.

Noam S. Weiss

With the ever-expanding use of life settlements by financial professionals of all varieties, the question being asked more frequently is: Does a life settlement make sense in my client's specific situation?

Life settlements are easily defined as the exchange of a life insurance policy for a cash settlement. Today's marketplace features sophisticated capital institutions on the funding side of the business as well as increased government regulations to protect the insured and the policyowner. These changes, along with the value proposition being offered and the abundance of eligible life insurance policies, are creating an expanding secondary marketplace. Utilizing a life settlement broker, any financial professional can access this marketplace to determine a policy's fair market value. At Settlement Benefits Association, we conduct these policy appraisals for free and without obligation. However, this information is only part of the value equation.

Just like any other financial decision that we assist our clients with, we must consider the client's unique individual situation. This perspective should include, but not be limited to, such questions as:

- What are the financial goals of the client?
- How close is the client to obtaining those goals?
- What other assets does the client own?
- Which of these assets are liquid?
- What is the client's health and family situation?

When evaluating this portfolio, advisers need to understand the role of life insurance. Often, life insurance is used to maintain a certain standard of living or to bridge the gap between the financial needs of dependents and the amount available from other sources. These sources, such as Social Security benefits, available cash, and other investments, may not be able to cover the dependents' needs. However, you must also consider how this asset portfolio will change with the infusion of cash generated by the life settlement itself.

Understanding the ramifications of keeping or selling a life insurance policy should also include a look at potential tax liabilities (if any). Although the following information is not intended to substitute for the advice of a tax expert or CPA, generally, the tax structure is as follows:

- Zero tax on the basis amount of the policy. (The basis represents premiums paid into the policy.)
- Ordinary income tax on earnings above the basis. (The combination of the basis and earnings is known as the cash surrender value.)
- Capital-gains tax on the amount in excess of the cash surrender value.

Furthermore, as professional advisers, we need to understand the other ramifications of keeping or selling a policy, including opportunities for charitable giving, the availability of less expensive replacement coverage or the purchase of long-term care insurance using the life settlement proceeds, whether the policy is draining cash in a trust, and so forth.

In summary, to understand whether or not a client should embark upon a life settlement we must first understand the client.

We must contemplate the client's broader financial picture and the place of life insurance within that picture. Only then can we truly understand the full implications of selling a policy and understand which option is best for our clients. ■

Noam S. Weiss is the managing partner of Settlement Benefits Association, a full-service life settlement brokerage in Tampa, Fla. Through a network of licensed funding groups, the company helps policyholders and their trusted agents to understand and maximize the value of life insurance products. Through their attention to service they are committed to exceeding client expectations. Settlement Benefits Association has received the approval of the National Ethics Bureau, an organization of approved financial advisers who have maintained an exemplary record of business ethics. Noam may be reached toll-free at 888-255-0444, or visit www.SettlementBenefits.com.

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ed time period (known as the *Crummey power*). It is necessary to maintaining the policy that the beneficiary *not* withdraw the funds. The beneficiaries may allow the right to expire or notify the trustee of their intent not to remove funds from the trust in writing.

The beauty of the life policy is that the benefits are paid in cash. If the majority of a family's assets are tied up in the family business, investment real estate, or other nonliquid property, the cash from the policy gives the beneficiaries the opportunity and time to consider a wider range of options with less stress since raising cash is not an issue.

Whenever you hear, "I don't need an estate plan; the estate tax is being repealed," you are looking at a prospect! This person is telling you that he has done nothing and is relying on a favorable tax utopia where all federal and state estate taxes are gone, income tax is forgiven on IRD assets, he only has one spouse and one child (who will never disagree), and his business interests will continue without management while producing sufficient income for the surviving family without a reduction in their standard of living. And, the biggest fallacy of all…the tax laws will never change.

Like "Little Red Riding Hood," it's a fairy tale. A good estate plan is, and will continue to be, reality. ■

Notes

1. Tom Herman and Rachel Emma Silverman, "Republicans Consider Keeping Estate Tax Alive for the Very Rich." *The Wall Street Journal,* January 19, 2005, p. D2.

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