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MONEY

Life Insurance for Sale -- In a Secondary Market

Policyholders Raise Money By Treating Their Coverage As Asset and Unloading It

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Don't be surprised if an insurance agent calls you with a new sales pitch: Sell your life-insurance policy to someone else.

The idea, which is gaining in popularity among older policyholders, is to raise cash from a policy now, rather than wait until death.

The tactic mirrors a controversial practice from the 1990s in which terminally ill patients, particularly those with AIDS, sold their policies for cash to cover medical costs. Those investments, known as viaticals, burned many investors when new AIDS drugs that substantially prolonged the lives of patients became widespread.

THE DEATH BENEFIT

What to look for when buying someone else's life-insurance policy–or selling your own.

For investors:

- **If you miss a premium payment**, the insurer can cancel the policy, and you risk losing your entire investment.
- **If you buy term policies**, make sure they can be converted into universal-life policies or can be renewed.
- **Beware of policies less than two years old**; many can be voided if a pre-existing condition results in death within two years of taking out a policy.

For sellers:

- **Don't sell your policy** if you need life insurance because a replacement policy could be impossible to get or prohibitively expensive.

A decision over the summer by the National Association of Insurance Commissioners could further boost these transactions, which are called life settlements. The group decided that insurance agents don't need separate licenses to broker the sale of a policy. A number of states had required a separate license. "That will hugely broaden this market," says Doug Head, executive director of the Orlando, Fla.-based Viatical and Life Settlement Association of America.

In a life-settlement transaction, a policyholder sells an existing policy to an investor, who then is named the beneficiary. The investor pays the premiums and collects the payout when the seller dies. The vast majority of investors are institutions, but some individuals and investment clubs dabble in them, too.

Already, the face value of policies sold in life-settlement transactions amounts to more than $2 billion, according to Conning Research and Consulting, a financial-services

• **Remember that your heirs** or your widowed spouse will not receive a payout when you die.

• **Life-insurance payouts are tax-free**; proceeds from the sale of a policy aren't.

Source: WSJ research

firm in Hartford, Conn. The life-settlement industry is growing at an annual rate of just under 20%, Conning estimates.

For many policyholders, the idea of selling an insurance policy to a stranger is an unusual one. People generally assume that life-insurance policies -- particularly term policies, which provide coverage for a set number of years and then go away -- have no value to anyone but the insured and the beneficiary. Indeed, owners let nearly 90% of all term policies lapse, so the insurance company never has to pay a claim. What policyholders sometimes don't realize is that a policy is an asset that has a market value.

Life settlements can make sense for sellers who no longer need coverage and no longer want to pay premiums. Selling an unwanted policy increasingly is becoming a financial-management tool for older people who face a cash crunch, who don't want to rely on their children for financial support or who are trying to find the money for costly long-term-care insurance. Some holders of term policies sell them instead of letting them lapse because they've found equal or better insurance coverage at a lower rate.

Buyers are investors chasing profits. Life settlements can generate annualized returns of between 5% and 14%, according to professionals who either buy the policies or who help insured people sell.

Insurance companies typically dislike such sales. After all, insurers have priced life-insurance policies with the idea that most will lapse and insurers won't have to pay any benefits. With more policyholders selling to investors, insurers now face the increased likelihood that the contracts will remain in force and require payoffs someday.

Agents and brokers, however, are able to generate commissions from the sale of a policy, and sometimes yet another commission if they can persuade a seller to invest the proceeds in a long-term-care contract or an annuity.

For people with universal-life coverage, which combines a death benefit with a savings component, the value of a policy in a life-settlement transaction is generally at least three times the underlying cash value of the policy, says Mr. Head, of the Viatical and Life Settlement Association. Even term policies, which have no underlying cash value and typically disappear at the end of a set amount of time, are worth something -- often between 10% and 30% of the policy's face amount.

That can be a significant amount of money. Maple Life Financial, a Bethesda, Md., buyer of policies, recently paid $248,947 for a $1 million term policy held by a 66-year-old. The firm also paid a couple in their 80s more than $232,000 for a $2 million universal-life policy that had a cash value of $54,300.

Unlike with viaticals, terminal illness isn't a necessity of life settlements, though sellers generally must be at least 65 years old and own a policy that will pay at least $200,000. Mark Feinstein, managing partner at Aaronson, Rappaport, Feinstein & Deutsch, a New York law firm, says the firm and a partner in his 60s had three $1 million term policies in force on the partner's life. In replacing those policies a few years ago with ones that charged cheaper premiums, the firm realized the old polices had value to investors. Instead of letting the contracts lapse, "we sold them for [a combined] $160,000," says Mr. Feinstein. "I thought they had no value. I would have just turned the policies in for nothing."

Investing in life settlement can be risky. Investors will fare poorly if the insured lives longer than expected. Moreover, miss a premium payment and the insurance company can terminate the policy, meaning investors lose their entire investment. If you're not careful, you could buy a term policy that expires before the seller does. For that reason, most pros buy only term policies that are convertible into universal-life policies or can be renewed. The premiums, though, often jump after renewal. Also, beware of policies less than two years old. Most policies have a clause that allows an insurer to nullify the contract if a pre-existing condition results in death within two years of the insured's taking out a policy.

Sellers run risks, too. If you know you need life insurance, don't sell. You could find that at an advanced age replacing your insurance is impossible or prohibitively expensive. Also, heirs or a widowed spouse get nothing when you die, possibly creating hardship or ill-will within the family. For that reason, life-settlement companies generally make a beneficiary endorse the sale. And while an insurance payout is tax-free, the proceeds on the sale of an insurance policy aren't, so you'll owe taxes on the money received in a life settlement.

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