Robin & Peter on LIFE SETTLEMENTS

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Life Settlement Sheds Light on Important Planning Tip

A recent life settlement case revealed an important, but often overlooked, planning consideration when obtaining large face amounts of insurance.

The case involved an 87-year old male and two identical $2 million survivorship universal life policies that were bought in 1996 for estate planning. The insured's wife had since passed away. The policies were originally bought using a single premium based on the then current assumptions. Due to declining crediting rates, however, these policies were going to lapse in a year or two. The surviving husband was now suffering from dementia and required very costly full time care. Neither the insured, nor his children, could afford to keep both policies as well as meet the insured's medical expenses.

To preserve some of the death benefit, as well as to create immediate liquidity, we suggested doing a life settlement on just one of the policies. $890,000 was obtained for the one policy, which, at least for now, provided enough cash to meet the insured's medical expenses as well as to continue funding the other policy.

What makes this case stand out is that the client had obtained two $2 million policies (one for each of his sons) rather than a single $4 million policy. At the time the policies were obtained, it was determined to be more convenient to have two policies, one for each son and his family.

It is highly unlikely this deal could have been consummated had only one $4 million policy been acquired. Except under very limited circumstances, our experience has shown that most insurers will not permit policies, other than term, to be split - especially if they suspect that a life settlement might be in the offing.

Had there only been one policy, the only options would have been to sell the entire $4 million or reduce the face amount. Either choice would have produced a less favorable result. Had the entire policy been sold, they would have had additional funds for the care of the insured, but no remaining coverage. Alternatively, had they reduced the face amount, no additional funds would

have been realized for the insured's care.

There is an important lesson to be learned here. Because insurers are reluctant to allow existing policies to be divided, it may be wise to buy two or more smaller policies at the outset rather than one large one. There is a slight cost to this strategy as the purchaser incurs multiple policy fees, but that relatively insignificant additional expense provides options that can yield huge benefits as illustrated by this case.

Some insurers won't permit policies to be acquired in smaller amounts at the outset, fearing that some sort of speculation might be going on. Nevertheless, breaking up a large purchase into smaller policies can be a wise and prudent decision. If an insurer objects to the strategy, then consider splitting the business between more than one company. This can also be a wise diversification strategy.

It was mostly "dumb luck" that this case worked out as described. Back in 1996, when the policies were bought, life settlements were not even on the radar screen. It was just felt to be more convenient to have a separate policy for each child. The favorable outcome of this case offers insight into a planning idea that could pay huge dividends for your clients.

While no policy should be purchased speculating on a future life settlement, skillful estate planning attempts to handle as many contingencies as possible. In these times of uncertain estate tax laws and economic hardship, positioning an estate for the possibility of a smaller insurance need or a reduced ability to pay premiums is prudent planning.

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