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Selling Your Life Insurance: Good Policy?

It Can be for Seniors Who No Longer Need It, but Some Financial Advisers Are Skeptical

By LYNN ASINOF

If you're over 65 and your health has taken a downturn, there are some companies interested in buying your life insurance.

In the past year or two, "life-settlement" companies have sprung up to buy life-insurance policies from seniors. The companies buy policies for a fraction of the death benefits, pay the premiums in the meantime, and then collect on the policies when the seniors die.

It is a tempting offer for seniors who no longer need their insurance — perhaps because their beneficiaries have died — or who can't afford to keep up the premiums. They get cash up front and freedom from continued premiums. And while the payment is less than the death benefit, it is usually far greater than the trade-in "cash value" of a policy.

For example, Stone Street Financial Inc., Bethesda, Md., says a retired businessman recently sold $500,000 of life insurance for $75,775. That compared with the $5,000 cash-surrender value offered by his insurance company if he had simply turned in the policy.

But some financial advisers are skeptical that selling life insurance makes sense for many seniors. For one thing, sellers will have greater tax exposure. While life-insurance benefits aren't taxable income, a life-settlement payment is. "You are giving up tax-free income," says Martin Nissenbaum, national director of personal-income-tax planning at Ernst & Young, New York. "That is a really major consideration."

Life-settlement companies are trying to remedy that by seeking special tax-exempt status for these payments to seniors. The proposal is similar to legislation approved in the 1990s making such life-insurance settlements tax free for people with less than two years to live.

Also, if seniors give up their insurance and find they need it later, they may not be able to buy it at any cost. And then there is the problem of unhappy heirs, who might have preferred that Dad kept his $5 million policy intact. To protect against such problems, some companies require beneficiaries as well as the insured to sign off on any sale.

As for value, Peter Katt, a fee-only insurance adviser in Mattawan, Mich., says the proper way to assess such transactions isn't simply to compare purchase price with cash value. Instead, he says, you have to measure "what the policy is worth to you when you factor in the premiums necessary to keep the policy in force."

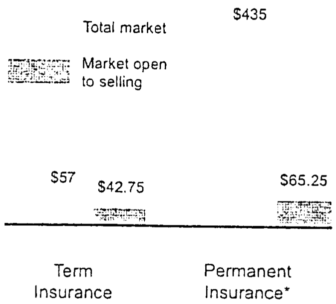
Based on his analysis of actual policy sales, Mr. Katt says there is a 90% chance that the policyholder would do better financially by holding on to the insurance than by selling. In fact, if the insured actually died when expected, the policyholder would get more than twice the amount netted in a sale.

"Life insurance is still a great asset," he says, noting that the life-settlement companies wouldn't be interested if it weren't.

That's true, says Alan Buerger, chief executive officer and co-founder of Coventry First LLC in Fort Washington, Pa. "People shouldn't be selling their policy if they have the means to keep it," he says. "But the reality is that people drop insurance every day."

For Sale

Individuals age 65 and over have a total $492 billion of life insurance in force. By one estimate, holders of some $108 billion of that may be open to selling their policies.



*Includes whole life, universal life and variable life
Source: Conning & Co. study, 1999

Until recently, people who wanted to cash in their policies had just one exit strategy — the insurance company. And that's just for permanent insurance, such as whole life. Term insurance offers no cash-value settlement if you stop paying premiums. Mr. Buerger, says his company on average offers five to six times the current cash value. "That's a terrific deal if they are going to drop it anyway," he says.

For the life-settlement companies, the approach is very similar to the companies that bought life insurance from AIDS victims a few years ago. These so-called viatical companies ran into trouble after new drug regimens indefinitely extended the lives of AIDS patients. But the life-settlement industry is banking that there will be no cure for old age. They buy policies only of people over 65 with a recent change in health, making it likely that death benefits will be paid sooner than originally expected. Unlike many in the viatical industry, life-settlement companies don't sell to individual investors, but rather package the policies they buy into portfolios for institutional investors.

Since Jan. 1, Living Benefits Financial Services LLC, Minnetonka, Minn., says it has received applications from people wanting to sell more than $1 billion of insurance, and it expects to purchase $300 million this year. And Coventry First says it has had $2 billion in applications since Dec. 1, and has already purchased $300 million.

So who wants to sell? "Eighty-five percent of the policies that come on the market are universal life," says Mr. Buerger. Premiums on these policies, which vary along with the insurers' investments, have gotten unexpectedly high in the current economic environment.

About a third of the life-settlement market involves key-man policies — purchased to protect a company from financial loss if a key executive dies — that are no longer needed, says Paul Moe, chief executive officer and chairman of Living Benefits. Then there are cases where beneficiaries have died or charities have been given donated policies on which they must pay premiums.

But determining that a policy is unneeded is a decision that shouldn't be made alone, says George L. Cushing, a partner with the law firm Kirkpatrick & Lockhart, Boston, noting that the target market can be vulnerable to a strong sales pitch. "Elderly people who are ill don't always get good advice," he says.