Get Savvy Before You Sell Your Life Insurance Policy

By: Janet Kidd Stewart
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Want to raise cash during retirement from someplace other than your retirement accounts?

You might consider a reverse mortgage, but those can be expensive. Hawking Grandma's antiques on eBay may bring in some dough, but you might regret the loss of family heirlooms.

Selling a life insurance policy you no longer need seems like a perfect solution, akin to putting unwanted items out in the garage and collecting a little return from the neighbors on your old junk.

The $13 billion life insurance secondary market operates like the world's largest life insurance garage sale--an offshoot of the viatical industry. Legal descriptions of life settlements and viaticals vary among the states, but viaticals generally refer to insured people who have terminal illnesses, and receive a percentage of what would be their death benefit while still living. Life settlements, meanwhile, typically are arranged for healthier (and typically wealthier) insureds who no longer want their policies.

Life settlement third parties, or brokers, have sprung up largely in the last decade. They offer cash above an insurance policy's surrender value (or a sum based on a percentage of the face value of a term policy), but less than the death benefit, for life policies of older Americans. In turn, the third party continues the premiums and is named as beneficiary.

Say a company owns a $3 million term life insurance policy on a key executive. When the executive retires the company might stop paying premiums and recoup nothing. By selling the policy, however, it might recoup 15 percent of the face value of the policy, said Lee Slavutin, a New York life insurance agent and consultant with Stern Slavutin-2 Inc.

On average (and this varies widely depending on policy type, health of the policy owner and other factors), life settlements on permanent insurance pay policyholders three to five times the cash surrender value, according to the Life Settlement Institute, an industry group.

But there's a new wrinkle in the life settlement world that may crimp what Sanford C. Bernstein and Co. forecasts will be tenfold growth for the industry in the next several years.

Last month New York Atty. Gen. Eliot Spitzer filed a civil suit alleging fraud and antitrust violations against Coventry First LLC, one of the largest third-party buyers of policies.

The suit alleges that Coventry uses anticompetitive practices to keep consumers from obtaining the best prices for their policies.

Coventry issued a strong denial, arguing that its existence has helped break insurance companies' hold on policy owners.

Several legislative proposals also are circulating that would increase regulation or limit or simply ban the arrangements.

"The Spitzer complaint gives us momentum to further crack down on this business to make sure it's honest and fair to consumers," said Jim Poolman, North Dakota's insurance commissioner.

Before that happens, what's a consumer to do?

Policy owners need to determine if a life settlement is in their best interest in the first place.

Clients who have whole-life policies with a cash value may be far better off to borrow against those policies for the cash value than sell them, Slavutin said.

Another key seems to be acting as your own antitrust officer.

Keith Singer, a certified financial planner in Plantation, Fla., said that, depending on the client, he may approach life-settlement brokers or go directly to firms buying policies. Whichever he chooses, he makes sure to have at least two people competing for the business to make sure he is obtaining the best offers, he said.

Slavutin, a broker himself, agrees.

"You always want to get competitive bids in writing," he said.

One of his recent clients, a 56-year-old physician, came to him for advice on what to do with a $3 million whole-life policy that she bought at age 36 but no longer needed for the insurance protection.

When Slavutin ordered an updated projection on the value of the policy he learned she no longer needed to make premium payments because of the large cash value. Further, she could dip into that value for a $700,000 home renovation.

In other situations, particularly universal life policies, selling to a third party might make sense, he said.

Finally, be sure to consider taxes when deciding whether to sell a policy, said Bruno Graziano, a tax expert with CCH Inc. in Riverwoods.

If you sell a policy for greater than the surrender value you will owe capital gains taxes on the amount above the surrender value, he said. Ordinary income rates apply to the difference between the amount invested and the surrender value.

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