

A GUIDE FOR ADVISORS

► *What is a Life Settlement?*

A Life Settlement is the sale of a life insurance policy to a third party for an amount greater than the cash surrender value. Typically, the sale involves an insured age 65 or older with a policy that is no longer needed, wanted or affordable to an investment company that provides the owner of the policy with a lump sum cash settlement. This secondary market for life insurance contracts has evolved into an alternative to accepting the issuing insurance company's surrender value for the policy.

► *What are the most common situations for a Life Settlement?*

Policy about to be surrendered or lapsed

- *Premiums too burdensome*
- *Underperforming – not meeting expectations*
- *No longer needed or wanted*

Change in business situation

- *Business sold or merged*
- *Termination or change in executive benefit plan*
- *Retirement or departure from business*

Change in estate plan

- *Reduction in the size of estate or estate tax liability*
- *Death of a spouse or other intended beneficiary; or divorce*

Change in priority of needs

- *Retirement and/or the need for additional income*
- *Post-bankruptcy and/or to pay off debt*
- *Need to pay for long term care*

► *How can your clients use the proceeds from a Life Settlement?*

- Supplement income
- Investments
- Long term care insurance
- Create capital for business opportunities
- Lower debt
- Provide educational funds and/or current gifts
- Create capital for charitable giving
- Pay for medical services
- Anything – the proceeds are unrestricted

► *Who are candidates for a Life Settlement?*

Insured's most likely to qualify are age 70 or older, or age 65+ with a medical condition and/or a change in health since the policy was issued. The policy should have a minimum death benefit of \$50,000 and be written by a company rated 'A' or better by Standard and Poor's. Generally the cash surrender value should not exceed 30% of the death benefit.

► *What types of policies can qualify for a Life Settlement?*

- Universal Life
- Term
- Second-to-die or first-to-die
- Variable Life
- Whole Life

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► **What is the process to obtain a Life Settlement offer?**

The owner of the policy and the insured complete a brief application, which includes authorizations to obtain medical and insurance information and a disclosure form. In addition, an in-force illustration of the policy to maturity is required which can be requested from the issuing company. Medical records, generally for the past two years, are obtained. Once LDA has assembled the required data, it will search for a settlement company (provider) willing to make the highest offer for the policy.

Once an acceptable offer is found, closing documents are prepared. Sign-offs from the insured, owner (if different), and beneficiary are required. The funds are deposited into an escrow account until the insurance company records the change of ownership and beneficiary. When the transfer is complete, the money is wired to the previous owner. The entire process normally takes about six to eight weeks.

► **What are the tax implications?**

There are no specific rulings on the tax treatment of a Life Settlement. The prevailing view is that proceeds are received:

- Tax free up to the owner's basis
- Ordinary income to the extent the cash surrender value exceeds the basis
- Long term capital gain treatment on any gain in excess of the cash surrender value

Life Distributors of America, LLC does not provide tax or legal advice. Interpretations of tax laws may vary.