



# Questions and Answers Regarding the Process of Life Settlements

**T-Horizons LLC**

Life Settlement Intermediaries

[www.t-horizons.com](http://www.t-horizons.com)

888-337-4436

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## Questions and Answers Regarding the Process of Life Settlements

Many American seniors—typically those 70 years of age or older—are discovering that the life insurance policies that they bought many years ago no longer meets their needs. Perhaps they find the premiums to be too expensive or they have too much insurance because their financial situation has changed. Normally the policy owner has only two courses of action regarding an unwanted policy:



1. Let it lapse (no longer pay premiums) or
2. Cash it in with the insurance carrier themselves for the *cash surrender value*

Generally speaking, the surrender value on a life insurance policy is a fraction of what one may receive from a life settlement transaction. The secondary market may provide funds that reach 5-8 times the amount of the cash surrender value including convertible term policies that do not even have a cash value.

The life settlement market has provided an important alternative to merely selling the policy back to the insurer or allowing the contract to lapse. When carried out in such a way that is appropriate and suitable for all who are involved, a life settlement is a tremendously valuable financial vehicle.

### Question – What is a Life Settlement?

**Answer** - A life settlement is a financial transaction in which a policy owner possessing an unwanted or unnecessary life insurance policy sells the policy, allowing them to convert the policy into cash. Funds received from a third party (generally financially stable investment institutions) are usually for more than 4-5 times the cash surrender value but less than the face amount of the policy.

The proceeds are given to the owner (usually in a lump-sum payment of cash) and used as they wish for retirement, charitable giving, medical costs, vacations, investments, travel, etc....Other benefits include relief from the payment of premiums or a vehicle to replace underfunded or inappropriate plans of insurance.

The purchaser becomes the new beneficiary of the policy at maturation and is responsible for all following premium payments.

### Question – I've been told that life settlements are illegal. Are they?

**Answer** – You have been misinformed. Life settlements are very legal and have been around for many years. The courts decided in 1911 that selling a life insurance policy was

well within the legal rights of the policy holder. The confusion lies in the concept of lack of *insurable interest* when the policy was first purchased by a stranger.

When an existing policy, purchased in good faith by the insured or a party who has an insurable interest in the insured, is later sold to an investor, even though the investor is a stranger to the insured, the insurable interest is not an issue because it was properly established when the policy was first issued.

**Question – Is a life settlement the same as a viatical settlement?**

*Answer* – A Life Settlement is based on longer life expectancies than a viatical which are settlements on policies of an insured having a life expectancy of 24 months or less. Viaticals were well-known in the 1980's with the advent of HIV and AIDS where the terminally ill had the opportunity to receive their death benefits for costly treatment while they were still alive. As life expectancies for AIDS victims continue to extend, viatical settlements have diminished.

**Question – What are some of the reasons why I might consider the sale of my life insurance policy to a life settlement company?**

*Answer* – The fundamental benefit of a life settlement is that it allows people to respond to their changing needs. Life settlement opportunities are circumstances and situations where the life settlement benefits listed above can be realized.

There are a variety of unique circumstances and situations in which a life settlement may make an appropriate and suitable strategy for individual policy owners as well as for entities such as trusts, partnerships, corporations, and not-for-profit organizations. The following are opportunities in which a life settlement may prove to be a valuable tool:

- The life insurance policy is no longer needed or wanted and the intention is to surrender the policy and use the funds to meet other needs or objectives
- Premium payments have become unaffordable and would have to –absent a life settlement- allow the policy to lapse
- Term policy is nearing the end of its guaranteed level term period. Converting the term policy to a permanent product (if available) and then selling the insurance via life settlement can bring value for an asset that the owner may otherwise allow to lapse without receiving any value.
- A survivorship policy is preferable to a single life policy
- Change in estate planning needs:

1. The insured's beneficiaries no longer have a need for the policy proceeds because they are financially independent adults
  2. Changes in estate tax laws have made a previously taxable estate now exempt from estate taxes
  3. Reductions in the size of the policy owner's estate have decreased so that the current policy is no longer appropriate
- Change in life circumstances:
    1. A policy may need to be sold as part of a divorce agreement
    2. Policy owner is divorced and the beneficiary was the spouse now in different circumstances
    3. Primary beneficiary named in the insurance policy predeceases the insured
  - Change in business circumstances:
    1. A key executive has retired, takes a new job, or is terminated and the coverage is no longer necessary. (Getting back the premiums paid on a key man policy is an effective way to fund coverage for his/her successor.)
    2. A corporate buy-sell agreement was established and one of the partners has either died, sold their shares or left the company - eliminating the need for the policy
    3. A business is sold and the old owner does not continue working for the new owner. The insurance covering the former owner's life may no longer be needed.
    4. A company bankruptcy requires assets to be liquidated. Corporate owned life insurance may have value.
  - Opportunities for Charitable, Academic, and other Organizations
    1. A policy was donated to a charity. The charity has immediate needs rather than wait for death benefits. The charity, now the policy owner, may not be able to afford to pay premiums so it plans to surrender the contract.
    2. An insured gifts a life insurance policy to charity and provides annual gifts to cover the premiums. However, after a time, the donor (or a surviving spouse) can no longer afford to make gifts sufficient to cover annual premiums.
    3. A policy owner wishes to give a life insurance policy to charity. The cash from a life settlement can instead provide a gift to the charity and a more attractive charitable deduction compared to the gift of the actual life insurance policy itself.
    4. A not-for-profit organization takes out life insurance on its board members for endowment fund. When economic hardship makes annual premiums unaffordable, a life settlement may be a good option.

**Question – What specific advantages can a Life Settlement provide?**

*Answer* – The benefit of a life settlement is that it is a most important tool that allows policy owners to proactively manage life insurance holdings to match changed needs and/or circumstances giving greater flexibility in the overall financial, retirement, and estate planning process.

Here is a partial list of some specific benefits that life settlements may provide:

- Lump-sum payment of cash
- Larger payouts than cashing out the policy at the insurance company
- Relief from the payment of premiums
- Vehicle to replace underfunded or inappropriate plans of insurance
  - Buying long term care insurance
  - A more appropriate paid-up life insurance policy
- Liquidity to fund:
  - Donating money to a favorite charitable or non profit organization
  - Gifting now to a family member
  - Paying for unexpected medical costs
  - Retirement expenses
  - Investments
  - Estate planning

**Question – Does the sale of a Life Insurance policy raise any special concerns or risks?**

*Answer* – Professional advisors must provide their clients with an objective and intellectually honest review of the advantages and disadvantages affecting the life settlement decision-making process.

One of the biggest risks is whether the insured possesses the requisite mental faculties required to enter into such a transaction. The sale of the policy could be voided if later shown that the insured was not mentally competent.

Life settlement proceeds may be subject to creditor claims. A life settlement transaction may affect your eligibility for state or federal government programs, such as Medicaid, the Supplemental Nutrition Assistance Program (food stamps), or other programs.

Almost all the financial benefits afforded by the policy to the policy holder and beneficiaries are eliminated. These can include:

- Forfeiture of the payment of the tax-free death benefit
- Inability to receive accelerated death benefits
- Inability to make policy loans or make withdrawals from the policy's account value
- Giving up policyholder dividends

It is important to verify that the sale of the policy will not negatively impact the insured's ability to obtain additional life insurance coverage now or in the future. The company who purchases the life insurance policy will continue to keep the coverage *in-force* until the insured's death. Therefore, even though the insurance has been sold and is no longer owned by the former policyholder, the coverage still counts against the insured when applying for new insurance.

The policyholder and insured must be willing to authorize (with a signed HIPAA form) the disclosure of their non-public personal financial and health or medical information related to the life insurance policy that is the subject of the life settlement.

### **Question – Who is going to buy an unwanted life insurance policy?**

**Answer** – Life settlement investments are generally not considered suitable for individual investors. Normally, life insurance policies are purchased by financially stable qualified institutional buyers (also known as *funders* or *purchasers*) possessing large amounts of capital. These buyers have experienced case managers and investment analysts who expediently act to ensure that the privacy and confidentiality are maintained from start to finish.

Generally, life settlement providers can purchase a freely portable, unencumbered policy from any type of non-restricted owning entity such as an individual, trust, partnership, corporation, charity, etc. The buyers need to be certain they are buying an asset in which they will be able to collect 100% of the death benefit.

### **Question – What is my Life Insurance Policy Worth in the Secondary Market?**

**Answer** – Factors such as type of policy, age and general health of the policy holder are considered when valuing a life insurance policy for settlement consideration. The life settlement value is in *today's dollars*, given projected premium costs, life expectancy and death benefit. Policies without loans typically price better than those with large loans.

Policy amounts and investors differ, making it impossible to set a standard amount. The actual price the policyholder receives is essentially what an institutional investor is willing to pay – net all taxes, commissions, and other expenses. Policyholders should use a broker that thoroughly investigates the market to find the absolute best net offer.

One can generally expect to get a significant percentage of the policy's value — well in excess of the surrender value. However, professional advisors should perform an economic analysis to help determine whether or not a particular life settlement makes good financial sense.

## **Question – What is the Life Settlement process?**

*Answer* - The process involves a series of steps which are monitored by both state and regulatory agencies primarily for consumer protection and industry standardization. The steps include:

1. Consumer recognizes the need (individual, business, estate, charitable) or has been financially advised that obtaining a life settlement is in the best interests of the policy holder providing the minimum requirements are met:
  - Individuals 65 years of age or older
  - A life insurance policy from \$250,000 or greater (some exceptions)
  - Change in circumstances since the policy was issued
  - Life expectancy from 25 months to 20 years
  - Policy must be beyond the 2-year contestability period
2. A life settlement intermediary obtains preliminary information from the policy owner/insured to determine if the policy (Universal Life, Term Life convertible to Universal Life, Whole Life, Joint/Survivorship Universal Life, Variable Universal Life, Group) does indeed qualify for initial consideration as a life settlement. Basic information includes:
  - Insured's age, gender, medical condition, tobacco use (no medical exam required)
  - Policy type, amount, issue date, premiums as a percentage of face value, policy loans, and Cash Surrender Value
3. If acknowledged as a candidate, the intermediary coordinates actions with the professional advisor, client, and a licensed life settlement broker in obtaining further information such as:
  - In-force illustrations
  - Medical records
  - Life expectancy reports
  - Signed application

Law requires that any entities involved in the Life Settlement industry carry the necessary licenses to protect the safety of the insured, the policyowner, and the financial professionals advising the client.
4. Information is received and reviewed by a reputable broker underwriter, who may need more information to be obtained from insurance carriers, medical records, etc. Certain brokers have in-house medical directors whose expertise in identifying pertinent information help to expedite the life insurance valuation.
5. After underwriting is completed, the case and all documentation is presented by the broker (working on behalf of the policy owner) to multiple well capitalized institutional buyers (known as providers) representing third party underwriting sources in the secondary market.

6. Broker will negotiate with prospective buyers for two to three rounds to obtain the highest possible settlement offer for the policy.
7. A non-binding offer is presented to the policy owner for acceptance or refusal. If refused, process ends at this point.
8. If the offer is accepted, the buyer places all funds into escrow and contracts, closing documents, and change forms (owner and beneficiary) will be sent to the advisor for completion by the seller.
9. Once all documents are in order, closing takes place (policy holder need not be present) and the escrow agent releases funds to the policy holder.
10. Policy holder has a rescission period, established prior, whereby the policy holder can cancel the transaction, retain the policy and return funds.
11. After rescission period the policy transfer becomes binding. Ownership transfers to the financial institution.

**Question – Why work with a broker and agent (life settlement intermediary)?**

*Answer* - Life settlements are complex legal and financial transactions. Compliance regulations continually change, further complicating matters. Professional assistance is necessary not only to navigate this world, but also to maximize the policy's value in the marketplace and to locate an appropriate buyer quickly. The broker has the fiduciary responsibility to the policy owner and will negotiate the sale between the buyer and the policy owner, acting purely in the best interests of the policy owner.

The agent or life settlement intermediary will work as a liaison between policy holder, the insured (if different), the professional advisors, and seasoned licensed brokers. The Life Settlement Intermediary carefully screens reputable brokers for:

- Financial soundness
- Years of experience in the settlement life insurance business
- Professional designations and trade association memberships
- Quality of recordkeeping procedures and the means by which the broker maintains the privacy of health and personal financial information
- How the broker investigates the financial soundness of prospective buyers
- Experience and working relationships with as many institutionally-funded buyers as possible
- Requests multiple first round bids to encourage competitive bids to raise prices
- Knowledge of buyers favoring certain kinds of life insurance policies and which ones would be interested in making competitive offers
- Transparency in sharing full information on each bid upon receipt

The broker will negotiate with the funding sources to achieve the highest value on behalf of the policy owner. The agent or intermediary, acting as liaison between the broker and the policy holder, will present the best offer to the policy holder and if accepted make certain that the process comes to timely and favorable conclusion.

**Question – How long does it take to get the funds from a life settlement?**

*Answer* - Like any transaction, the time frame can vary. It depends on how quickly medical records from the associated physicians and pertinent insurance records from the insurance carrier can be retrieved. Cooperation from the policy holder in obtaining those records will greatly expedite the process. The process starting from the initial inquiry to final disbursement of funds can take from as little as two months to more than four months in duration.

**Question – What are the fees for a life settlement transaction?**

*Answer* - While there are no fees incurred by the policy holder (except professional advising fees), most states and insurance regulatory bodies establish guidelines, both financially and ethically, regarding compensation to brokers/agents/providers in the life settlement transaction. Commissions are usually based on a percentage of the face amount of the policy or gross offer for the policy. The commission is paid out to the provider/broker/agent via funds escrowed by the buyer of the policy.

**Question – What are the Tax Implications for Life Settlements?**

*Answer* - While the receipt of life insurance benefits by the beneficiary upon death of the insured is generally tax free, life settlement transactions can be a taxable event.

When thinking about the tax consequences of life settlements, it is important to think of the variety of policy owners and the important issues that are likely to surface:

1. Individuals
2. Trusts
3. For-profit entities
4. Executors of estates
5. Tax-exempt entities such as a 401(a) trust or 501(c) organization.

It is important that you consult with competent financial advisors, attorneys and/or CPA's for professional advice of income tax consequences of the proposed settlement *before* the transaction closes.

On May 1, 2009, the IRS issued Revenue Ruling 2009-13, which defines an individual policy owner's tax liability on the proceeds from the sale of a life insurance policy in a life settlement transaction. What follows are some general guidelines regarding taxation.

Upon the sale of a *cash value* life insurance policy:

- The proceeds from a life settlement are generally tax-free up to the amount of the premiums paid for the policy.
- The recognized gain is the difference between the net amount to client and the policy owner's adjusted basis - Calculated by subtracting the cost of insurance (determined by the carrier) from the total or "aggregate" premiums paid.
- Basis rules are subject to carrier interpretation. Carrier statements should be carefully reviewed so that basis can be verified for accuracy.
- In determining basis, financial professionals need to assess the bearing of:
  1. Additional premiums for supplementary benefits (waiver of premium, double indemnity, accidental death protection and disability income).
  2. Non-taxable distributions (cash dividends, dividends used to purchase riders or accumulate interest and nontaxable withdrawals).
  3. Dividends used to purchase paid-up additional insurance or reduce premiums.
  4. A Section 1035 exchange
- Any recognized gain greater than the adjusted basis and less than the policy's cash surrender value will generally be taxable as ordinary income.
- Amounts received in excess of cash surrender value that can be shown to be generated by market forces are generally *assumed* to be taxed as capital gain.

In the sale of a *term* policy, the IRS has ruled that:

- The premiums paid and the cost of insurance are both assumed to be equal, which means the adjusted basis will always be \$0.
- Any recognized gain will be taxed as a capital gain.

### **Question – What happens to my life insurance policy after I enter into a life settlement contract?**

*Answer* – The purchase agreement should give the policy owner the ability to rescind the transaction within a reasonable time period.

Once past the rescission period, the ownership rights and obligations under the policy are transferred to the new owner and a new beneficiary will receive the proceeds upon the death of the insured. All premiums will become the responsibility of the purchaser of the policy. The buyer then has three options:

1. Hold the policy until maturity, paying any carrying costs out-of-pocket or using leverage.

2. Assemble a portfolio of policies with various face amounts and life expectancies for re-sale to other investors.
3. Aggregate a portfolio of policies for use in a transaction of specific types of bonds issued to investors

**Question – What are the alternatives to entering into a life settlement?**

*Answer* – If you still need this life insurance, but can no longer afford premiums, there are several options to explore:

- Borrow against the cash value of your life insurance policy
- Have someone else pay the premiums
- Obtain a reduced death benefit policy
- Have the cash value in policy pay premiums
- Learn about a *policy rescue program* from your insurer
- Cash out the policy based on the available cash surrender value
- Check with the life insurance company to find out if the policy can be converted to a paid-up policy or if the death benefit can be reduced in order to lower the amount of your premium payments
- Use the life insurance policy as collateral to secure a loan
- Utilize an accelerated death benefit

Always seek the advice of a financial planning professional before making any final decisions.

**Question – Can a life settlement apply to a donated policy to a charity or other tax-exempt entity?**

*Answer* – Many people want to establish their philanthropic legacy and there is no better way to help than by donating an unwanted, unaffordable policy to their favorite non-profit. In cooperation with the tax-exempt entity the policy, can then be sold as a life settlement whereby the non profit reaps the benefits now rather than waiting until your passing.

There may be cases where you can offer a cash gift received from a life settlement. This may provide for a more attractive charitable deduction compared to the gift of the actual life insurance policy.

Such transactions have tax implications associated and it is strongly advised to seek professional advice before committing to such a donation.

Any senior who purchased life insurance years earlier for good economic reasons must re-examine those reasons upon entering retirement. Independent advice should be sought by any individual considering purchasing or changing life insurance policies.

## Case Scenarios

- A 73 year old male was interested in making some changes in his estate planning. He had a \$5,000,000 Universal Life policy and wanted to get cash upfront now to enhance other investments. The insurance company offered him a cash surrender value of only \$2,862.00. By pursuing a life settlement he received \$1,050,000 which was \$1,047,000 above the cash value offered by the insurance carrier.

- An 82 year old woman had a Universal Life policy in the amount of \$1,000,000. She and her financial advisors determined that she no longer needed all that coverage. She was advised to sell the policy and get a new paid up policy, more suitable for her needs payable with the proceeds. The insurance carrier offered her \$14,139 in cash surrender value. She received \$208,333 from the settlement which turned out to be \$194,194 more than if she just cashed out with the insurance company. She bought a lower face amount policy and donated the rest to her alma mater.

- Mr. B is 70 year old widower who had a \$500,000 term life policy with a cash surrender value of \$0. His current annual premiums were \$12,500 and he was going to let the policy lapse, because of the expense. He explored the idea of a life settlement and after multiple offers decided to take the settlement of \$114,500. What he thought of as a worthless policy turned out to be a windfall which he immediately allocated for his grandchildren's education fund.

- Jack had a \$350,000 Universal Life Insurance policy and needed to obtain Long Term Care insurance due to changes in his health. He looked at his financial picture and with the help of his financial team, decided to pursue a life settlement from his life insurance policy which he really didn't need. The cash surrender value from his insurance carrier was only \$1507. His life settlement was \$60,000. He put that money towards funding his Long Term Care Insurance policy.

- A company owned a key man policy for \$2,000,000 on an executive who had retired. The annual premium was exorbitant and the owners did not need to keep the coverage. The remaining partners decided to look into a life settlement for that policy and received a settlement of \$473,000 which they put back into the business and paid off back debt. If they had cashed it in with the insurance carrier they would have received only \$271,000 based on accrued value and would not have realized that through a life settlement they would have received an additional \$202,000! Luckily for them.

## About T-Horizons, LLC

T-Horizons, LLC is a *Life Settlement* cooperative brokering service. Our licensed life insurance/life settlement agent/brokers have developed through our partnering relationships with teams of experienced registered financial and life settlement professionals an educational, due diligence, and a management process designed for a smooth and satisfying settlement experience through each level of service. Through negotiations with numbers of competitive secondary market funding entities from the nation's leading institutional capital sources, your settlement values on qualified policies are maximized.



Dr. Vincent DiLorenzo, President  
Licensed Life Insurance and Life Settlement Agent

[drd@t-horizons.com](mailto:drd@t-horizons.com)

888-337-4436 Voice/Fax

267-808-1364 Cell

Dr. Andrea Brockman, CEO  
Life Settlement Intermediary

[drb@t-horizons.com](mailto:drb@t-horizons.com)

888-337-4436 Voice/Fax

267-808-0212 Cell