Never Surrender If You Can Settle Instead

BY LISA REHBURG

Ever since Benjamin Franklin helped start the first life insurance company in the United States in 1759, life insurance has been a key part of our lives and financial planning. Today — with more than 290 million policies in force — the U.S. leads the world in writing premiums for life insurance. This amounts to approximately $20.3 trillion in face value.

Life insurance can be a key part of planned giving. When a donor wants to donate a policy, that might be great but:

- What happens if the donor does not want to or can no longer pay the premiums?
- What happens if there is minimal cash value in a policy?
- What if the policy is a term policy?
- What if a nonprofit organization does not want to accept donations of life insurance?

A better alternative may be the life insurance settlement. Life settlements are designed primarily for people over the age of 65 with policies having death benefits of $100,000 and above.

Simply put, a life settlement is the sale of an insurance policy to a third party — usually an investor group — that results in a lump sum of cash paid to the owner for the policy. The investor group becomes the new owner, pays the premiums, and receives the death benefit. Once an insured receives his or her lump-sum payment, he or she can do anything with it. This includes giving all or part of the proceeds to a nonprofit organization as a one-time donation or to fund a charitable gift annuity, to name two options.

The charitable gift opportunity is much larger than simply surrendering a life insurance policy to generate cash. The reality is that life insurance is often a hidden asset that some people may even forget that they own.

How big is this opportunity? According to the Life Insurance Settlement Association (LISA), there are 38 million life insurance policies owned by American seniors over the age of 65. They have a collective face value of more than $3 trillion. In addition, research from the Insurance Studies Institute (ISI) shows 500,000 seniors each year allow their life

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program, including quarterly statements and other news from our organization.

I knew Bill had the capacity to give a more significant gift based on our ongoing conversations. I recently listened to a presentation from veteran planned gift expert Joe Bull that a typical planned gift could take up to three fiscal years to complete! Therefore, it's imperative that we have a sound tracking processes in place via a well-organized donor pipeline. I took the time to carefully plan my next "moves" with Bill.

Then one day, I received a call from Bill. He had just finished reading the most recent edition of my planned giving newsletter and was interested in learning more about our charitable gift annuity program. The institutional and personal stewardship paid off well. Bill's next gift was a gift annuity, which was also funded with appreciated securities — but was seven times larger than his initial endowment gift.

As planned giving practitioners, we need to know and understand our craft well. More importantly, we must be able to connect with donors on the issues, ideas, and problems that mean the most to them. Not every gift arrangement a prospect or donor proposes is good for them or the charity. However, doing our job well means being able to make appropriate arguments for the ideas that don't fit the gift acceptance policies.

It is important to understand our organization's policies and procedures. We also take time to listen to our prospects and donors about what matters most to them, and to have a sound stewardship process in place. When we stay focused in these areas, there will be a number of donors repeatedly making planned gifts, and they will make a significant impact for our organizations and the entire community.

The institutional and personal stewardship paid off well.

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insurance policies to lapse. That's a big number!

To put even more data forward, LISA's own research shows that Americans 65 or older leave over $100 billion in benefits on the table each year by either surrendering their life insurance policies or allowing them to lapse. These numbers are staggering, yet most people do not know another option exists. They let their policies "go" with little or no financial return.

The ISI survey found that 90 percent of seniors said they would have considered a life settlement had they known about the option. This presents an opportunity for nonprofits to cultivate additional gifts from life insurance. If people were going to let their insurance lapse anyway, might they be persuaded to convert it into a charitable contribution?

Who are these policyholders, and why would anyone allow his or her life policy to lapse? The short answer is because they either do not want or need it anymore. Perhaps the reason it was bought years ago no longer applies today, making the policy unnecessary. Clearly, there are 500,000 individual reasons a year why policies lapse, and they tend to fall into several categories.

- The sale of a business where the owner sells and the "key person" policy is no longer needed
- Increases in the estate tax exemption, when policies purchased years ago for estate tax purposes are no longer needed since the estate tax exemption doubled in 2017
- Policy limits are being reached (term insurance contracts that are about to expire, lose their conversion privilege, or are coming to the end of a premium guarantee)
- Retirement and other life changes, as when the family residence is paid off or income replacement in the event of a premature death is no longer needed
- The policy is no longer affordable due to policy performance (over time, some universal life policies are becoming unaffordable)
- A rental property or significant asset has been sold, so the policy purchased to cover payment for that asset is unnecessary

Policyholders even have the option to sell a portion of the policy. In other words, they may keep some coverage in force, if they wish.

What types of insurance policies can be sold? The most common type of policy sold is universal life, followed by term and second-to-die policies. Whole life, first-to-die, and group policies (if convertible) may also be sold. Just about any type of life insurance is an opportunity for a life settlement. Term policies typically need to be convertible and the conversion deadline cannot have passed (however, there are some rare exceptions).

But … is this legal?

Not only are life settlements legal, the process is very transparent and highly regulated. Believe it or not, a U.S. Supreme Court decision in 1911 paved the way for them. In *Grigsby v. Russell*, Justice Oliver Wendell Holmes wrote, "It is desirable to give to life policies the ordinary characteristics of property. To deny the right to sell except to persons having such an interest is to diminish appreciable the value of the contract in the owner's hands." A life insurance policy is an asset like an automobile or home; the owner has the right to sell or transfer to whomever he or she chooses.

Life settlements are regulated in 43 states and the territory of Puerto Rico. According to LISA, approximately 90 percent of Americans are afforded protection under comprehensive life settlement laws and regulations. The National Council of Insurance Legislators (NCOIL) and the National Association of Insurance Commissioners (NAIC) have been active in crafting model language and disclosure notices for consumers. These have been adopted by most states. Disclosure notices include transparency in the offer details, sales commissions, and alternatives to selling a policy. Further, sellers must be deemed competent to enter into a life settlement contract, and beneficiaries must consent prior to a policy being sold.

How is a life insurance policy valued through a settlement? It depends on the client's health, the premiums remaining to be paid, and the death benefit, to name a few common factors. Not all policies are good candidates, as some may be worth nothing and others could be worth tens and even hundreds of

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Americans 65 or older leave more than $100 billion on the table each year.

TRENCH TALES

- Fred is a practical guy with a wry humor, and both were on display when he brought up the disruption and expense of Daylight Savings Time. "If we could count the tens of thousands of hours we collectively spend adjusting our clocks, it would show that a tremendous amount of time is wasted twice each year. For what? Only government knuckleheads would come up with that stupid scheme. It is no different than if they told you to cut off a foot from the bottom of your blanket, sew it back onto the top, and then try to convince you that your blanket is longer.

- During our meeting, a donor told me that we'd need to reschedule our next appointment. It happens to coincide with the annual Rattlesnake Roundup in Sweetwater, Texas. "That's a bucket list item for me!" he exclaimed, as his wife rolled her eyes.

- Our distribution from a $3 million estate amounted to just $23.17 due to pending litigation — and the check bounced!

Anecdotes are supplied by readers of Planned Giving Today. Do you have an interesting or amusing story related to your work as a for-profit advisor or charity gift planner? Send it in so we can pass it on (tom@pgtoday.com). Names are withheld to protect the "guilty."

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thousands of dollars. It is worth finding out.

Some nonprofit organizations may routinely surrender a policy contributed by a donor. Through a life settlement, both the donor and nonprofit organization benefit from receiving substantially more than the surrender value for the policy. In 2013, the London Business School researched more than 9,000 policies and found that people who surrendered them received less than one-fourth the amount they would have received had they sold them. There can be substantially more value in selling the policy through a life settlement. Remember that even term policies (which by definition have no cash surrender value) can be sold.

Broaching the subject of a life insurance settlement should be a smooth transition for planned giving professionals, who routinely have discussions about assets to be donated. Remember that in 1911 the U.S. Supreme Court held that a life insurance policy is an asset, just like real estate. The question is simple: "Do you have a life insurance policy that you no longer want or need?"

With 500,000 seniors a year permitting their policies to lapse, it may be surprising how many times a planned giving officer hears the word "yes."

Life insurance is important for many people, and a settlement should never be entered lightly. The donor's financial professionals should be engaged to be sure it is the right decision for the donor. The 2017 Tax Cuts and Jobs Act was very beneficial for life insurance settlements, making them even more attractive from a tax perspective.

The number of American seniors is projected to continue rising from 42 million in 2012 to perhaps 70 million in 2030, so the life insurance settlement market will continue to grow. Life settlements are not appropriate for everyone. However, if the decision has been made to surrender a life insurance policy or let it lapse, a life settlement can offer significantly greater value for both the donor and the nonprofit.

The bottom line is this: Life settlements can convert an unwanted or unneeded life insurance policy into a meaningful gift. That contract is perceived by the donor to be worth nothing today, because he or she was going to stop paying premiums. This creates a charitable gift opportunity for nonprofits that ask for it.

"Do you have a life insurance policy that you no longer want or need?"

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