

# Life Settlements – Important Questions

**Did You Know...**that, in certain situations, unneeded or unaffordable life insurance policies can be sold for substantially more than the policy surrender value?

**This includes certain term life insurance policies that have no cash surrender value.** Last year, we brokered the sale of three term life insurance policies with a total death benefit over \$1,000,000. The sale value, after costs, was over 50% of the death benefit. The cash surrender value of the three policies was zero!

## **What is a life settlement?**

A life settlement is defined as the sale of an unneeded or unaffordable existing life insurance policy on the secondary market to a third party for a lump sum cash settlement. Using our Professional Life Settlement Solution™, the purchaser is an institutional purchaser. The purchasing fund often has over one billion dollars allocated for life insurance policy purchases. The portfolio of policies are managed (premium payments, etc.) by an institutional custodian.

In these institutional ownership arrangements, the policy is not owned by an individual who is “monitoring” the insured. Institutional investors will buy a large number of policies meeting their qualifications and use the death benefit payouts as an investment alternative to a bond portfolio, often in global retirement plans.

The sale of existing life insurance policies has been taking place for many years. We have represented policyowners wishing to sell their policies for approximately 15 years. Last year we settled seven policies, which is up from previous years. We think the number of life settlements will continue to increase for several reasons:

1. Insureds are getting older, making life settlements more viable.
2. With continuing low interest rates, more policies are going to be identified as underfunded, and more policyowners are going to be unwilling to pay the higher premiums required to sustain these underfunded policies.
3. Changes in business ownership and the increased estate tax exemption are going to label more policies as no longer needed.

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### **Why pursue a life settlement?**

1. The policy is no longer affordable by the policyowner. An institutional purchaser can afford almost any premium payment as long as it makes economic sense.
2. The policy is no longer needed, and a life settlement will provide more money to the policyowner than the policy surrender value.
3. In addition to the two reasons above, some policyowners have a very strong need or desire for the policy sale proceeds while they are living, rather than as a payout to their beneficiary(ies) after their death.

### **What are the characteristics of Our Professional Life Settlement Solution™?**

1. First, and foremost, we work with our broker dealer, Valmark Securities, to treat the policy sale as a securities transaction. Many other life settlements are not treated as securities transactions. A securities transaction requires that the policyowner receive the best purchase offer not, for example, only the offer paying the highest commission.
2. The policy purchaser is an institutional purchaser. Valmark Securities does extensive due diligence to identify appropriate institutional purchasers licensed in the state of the life settlement. As an aside, we must also be licensed as a life settlement broker. We believe there are fewer than 25 life settlement brokers with resident licenses in Wisconsin.
3. The sale should be carried out through a competitive bidding process among multiple providers rather than contacting only one or two potential purchasers. This process may help to increase the value of the sale and provide a high degree of assurance that the policyowner is receiving a fair market value settlement for the sale of their policy.
4. We provide full written compensation disclosures before the life settlement transaction is implemented. This transparency is very important and a requirement of a life settlement treated as a securities transaction.

**We set our all-inclusive compensation at the lesser of the following three calculations:**

<b>For a Policy with a <u>Death Benefit Less Than \$2,000,000</u></b>	<b>For a Policy with a <u>Death Benefit of \$2,000,000 or More</u></b>
6.0% of the death benefit	4.5% of the death benefit
30.0% of the gross offer	22.5% of the gross offer
One-third of the value created*	25.0% of the value created*
* The sale price in excess of the cash surrender value	

This compensation may be substantially less than the full compensation that could be taken. A reduction in compensation may result in a dollar for dollar increase in the sale proceeds realized by the policyowner. (Included in the above calculations is a predetermined amount of compensation to be paid to our broker dealer, Valmark Securities, for their administrative services in this life settlement securities transaction.) This compensation will be fully disclosed, and will be payable only if the life settlement transaction closes.

**What are some insured characteristics that could be candidates for a life settlement?**

1. The insured should have a life expectancy of 14 years or less. This usually means a male insured should be age 70 or older, and a female insured should be age 75 or older. We have completed life settlements on younger insureds who had significant health impairments.
2. The insured does not have to be the owner of the policy but the insured needs to be a cooperative participant in the life settlement process, including their authorization to release their medical records. No insurance physical exam is required.
3. The life settlement process is conducted with the policyowner. If a sale is completed, the policyowner will receive the sale proceeds

### **What are some policy characteristics that could be candidates for a life settlement?**

1. Our Professional Life Settlement Solution™ requires a policy death benefit of \$500,000 or more. Sometimes larger policies, even much larger, are more saleable.
2. If the policy is term insurance, it must be convertible to more permanent life insurance without any medical evidence of insurability. The sale must be implemented before the guaranteed convertibility provision expires in the term life insurance policy.

This guaranteed convertibility contractual provision lapses at older ages, often age 65 or 70. As a result, term insurance sales often have to be implemented at an age younger than the insured's age 70 or 75 as referenced above, requiring that the insured have significant health impairments.

3. If the policy is whole life or universal life insurance, usually:
  - a. The current policy cash value should be less than 20% of the death benefit.
  - b. The policy can be continued to the insured's age 95 or older. The ability to continue the policy to age 100 or beyond is preferred.
  - c. The annual premium to continue the policy to age 95 or 100 should be 5% or less of the death benefit depending upon the insured's age and health.
4. A cash value policy to be life settled can insure one person, or two people payable at the second death.

### **How does the process work?**

Our Professional Life Settlement Solution™ process starts with the insured authorizing the release of their medical records. The medical records are accumulated confidentially by Valmark Securities. When all of the necessary records are assembled, they are provided to two or more firms specializing in the calculation of life expectancies for the life settlement industry.

The combination of the two (or more) life expectancy calculations, the insured's age, and the projected premiums for the policy to be sold will determine if the policy is likely to be saleable for more than the policy surrender value. There is no cost or obligation for this analysis.

If everyone is in agreement than an effort should be made to sell the policy, all of the necessary information is distributed to several potential institutional purchasers. A bidding process will commence and continue until there is only the one highest bidder remaining. Their high bid becomes the purchase price, at which time the policyowner can decide to proceed with the sale or to have the file closed without cost or obligation.

If the sale goes forward to completion, Valmark Securities and our office will be compensated from the sale proceeds pursuant to the schedule in this white paper and disclosed to the policyowner in advance. The gross sale proceeds less these costs will be paid to the policyowner.

The sale document is a sizeable legal document. We always advise our clients to work with their legal counsel in reviewing and completing the sale document.

We hope this white paper provides you with a better understanding of life settlements and our Professional Life Settlement Solution™. A two-page Life Settlement Checklist is also included with this report. In addition, we have a one-hour professional continuing education (CE) program on life settlements for advisors. If we can be of further assistance to you as a client, or an advisor to your clients, please contact us.

In a life settlement agreement, the current life insurance policy owner transfers the ownership and beneficiary designations to a third party, who receives the death proceeds at the passing of the insured. As a result, the buyer has a financial interest in the seller's death. When an individual decides to sell their policy, he or she must provide complete access to his or her medical history, and other personal information, that may affect his or her life expectancy. This information is requested during the initial application for a life settlement. After the completion of the sale, there may be an ongoing obligation to disclose similar and additional information at a later date. A life settlement may affect the seller's eligibility for certain public assistance programs, such as Medicaid, and there may be tax consequences. Individuals should discuss the taxation of the proceeds received with their tax advisor. Valmark Securities, Inc. supervises all life settlements as a security transaction. Valmark Securities, Inc. and its registered representatives act as brokers on the transaction and may receive a fee from the purchaser.

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