Life Settlements for Term Insurance

by David Cherkas

Term insurance has been the bargain of the insurance marketplace for more than 20 years. It provides effective low-cost coverage that helps achieve a wide range of planning goals. Term insurance can be the answer for a corporate client who needs key-man coverage or a high net worth couple who needs income protection. But, for all of the reasons for clients to buy term, people assume that there are just as many reasons to let it lapse when the need for coverage passes. As we are about to see, that assumption may no longer be valid.

Term policies account for about 40% of new individual life insurance purchased each year. The popularity of term is largely due to a 20-year price war, which has steadily driven down term rates as insurers grapple for market share. With term consumers paying just 25% of what they once paid, it is no wonder that $1.3 trillion worth of new term policies are issued each year.

For most insureds, a term policy functions much like the disposable raincoat they bought on the way into a football game. After it provided affordable and effective protection for the duration of the game, they dumped it without a second thought. Likewise, billions of dollars worth of term insurance is lapsed every year. After all, why should a client keep paying for a term policy that is no longer useful? With the rise of the secondary market for life insurance, advisors are asking a very different question, "How much can my client receive for an unneeded term policy?"

What Is My Client's Term Policy Worth?

The life settlement of a term policy is one of the greatest opportunities presented by the secondary market for life insurance. Term life settlements represent a rapidly growing portion of the market. While it may seem counter-intuitive for clients to receive cash for unneeded term insurance, a large amount of term coverage on the books carries a value in the secondary market.

A term life settlement can be a boon to the client. Consider an example from the world of real estate. Imagine that your client rents an apartment. The lease lets him cover his housing needs by making regular payments and he has no expectation of a return when he moves out. Now imagine helping your client sell the lease for twice the amount he has paid out over the lifetime of the lease. What if you could collect compensation for selling the lease and helping the landlord convert the apartment to a condo? This is how term life settlements work. Clients win by receiving an unexpected return on their premium investments while dropping an asset that they don't need anymore. What does the advisor gain? For starters, the relationship with your client becomes stronger when you present them with value that they didn't know existed. In addition, you will have multiple compensation opportunities on the sale and conversion of the policy.

Here's a recent real-world example. A corporate client no longer wanted to pay the premiums for a $25 million term policy on a 66 year-old man. The client intended to convert $10 million and let the remainder lapse. The writing agent didn't recommend an appraisal. Fortunately, an attorney associated with the transaction introduced a second advisor who was experienced in policy valuation. This advisor helped the client with a $175,000 life settlement for the remaining $15 million in coverage. The company was so pleased with getting unexpected return on top of achieving their original goal of dropping the unnecessary coverage that they began sending additional conversion business to the second advisor.

The profile of good settlement candidates for term or for other types of policies has broadened significantly from the market's early days. As another recent case illustrates, an impaired life expectancy is no longer a prerequisite. A company was using an $8 million term policy as collateral for a credit line through a local bank. The insured was a 69-year-old male company executive with a life expectancy of 14 to 17 years. The premium payments were no longer tolerable to the company, which was planning to let the policy lapse. After an astute advisor recommended a valuation, the policy appraised for $500,000. The company chose a life settlement, which disposed of the original policy while generating significant cash to cover operating expenses, including a portion of the premiums for a new $6 million policy purchased at preferred rates.

These cases illustrate another compelling fact about term life settlements. Term insurance is a bridge to permanent coverage in the majority of planning scenarios. Until now, clients and their advisors have been content to drop the unneeded term coverage. However, by appraising and settling such policies, advisors can use the term policy's market value to give clients a springboard into far more affordable permanent solutions.

Tapping the Term Market

Considering that term clients never expect to see a return, underperforming policies represent a tremendous opportunity for advisors to bring new value to clients. Even better, the sheer volume of in force term insurance makes prospecting relatively simple. Here are a few suggestions on how to tap into the term life settlement market:

- Examine your book of business. Are any of your clients considering dropping or converting term policies?
- Talk with accounting and law firms since they are often involved in developing solutions for clients with larger term policies.
- Consider offering financial planning seminars, which can be another valuable prospecting tool.
- Study the published financials of public companies for corporate-owned term policies that may be suitable for life settlements.

Term life settlements are still an unrecognized opportunity. Building a thriving term life settlement business can be a powerful strategy to reach new clients and build core business. Realizing significant value for such "valueless" policies is a concept that any client will warm up to. ❑

