

Selling Your Life Insurance Policy Can Help Ensure Business Liquidity

By JUAN HOVEY, Special to The Times

Need cash to carry your business through the coming months? Take a look at those old cash-value life insurance policies listed as assets on your balance sheet. Policies insuring your key managers or guaranteeing pensions, for example, might prove more valuable than you think.

The real value of such a policy might exceed its cash value. And if you surrender it in exchange for that cash value, you might leave money on the table.

You can, of course, get your hands on the cash value of a whole life or universal life insurance policy by borrowing against it or by surrendering the policy. But now you have another option--selling the policy in the marketplace for "life settlements," a new and little-known way to wring unexpected value from unneeded life insurance.

The idea is not for everybody. Don't consider it at all unless you don't need the insurance anymore. It also takes some doing to effect a life settlement, and as you probably imagine life insurers don't encourage the practice. But under the right circumstances, a life-settlement transaction can prove a smart move for the business owner.

Life settlements resemble the viatical settlements first used in the 1980s to get cash into the hands of the terminally ill--for example, people with AIDS--to pay for costly medical treatment or even just to buy themselves a measure of comfort as death approached. They differ, however, in that it is not the moribund but the hale and hearty who may make use of them, often raising far more capital from a life settlement than represented by the cash value of a life insurance policy.

How much capital?

A man age 65 with \$200,000 in cash value in a \$1-million life insurance policy might get \$300,000 in a life settlement deal, according to Michael Cavalier Sr., president and chief executive of Cavalier Associates Insurance Services in Woodland Hills.

Cavalier cautions that the marketplace for life settlements is thin, meaning that there are few buyers of life insurance policies and not all who say they do deals actually have the capital to operate effectively.

"The real issue is to make sure that your funder has funds," Cavalier said. "Some funding companies say they have the money and they get everybody excited, and then there's no money to do the transaction. The problem is not that you jeopardize your life insurance policy. It's that you go after something that doesn't exist from the beginning.

"Don't give up your policy until you get what you're supposed to get--and don't go into this with unrealistic expectations."

The buyers in life-settlement transactions look on the deals as investments, pure and simple, Cavalier said. They don't commonly buy policies insuring the lives of the young or even the middle-aged, who in any case probably need their insurance, or policies with big cash values relative to the death benefit, as a rule. They also don't commonly buy policies with death benefits of less than \$500,000.

Thus, the good candidate for a life-settlement deal faces a life expectancy not exceeding 13 years as measured by insurance underwriting standards and holds a policy for more than \$500,000 with a cash value not exceeding 40% of the death benefit, he added.

This probably leaves out people holding "rich" whole life policies with big cash values.

However, those holding poorly performing universal life insurance policies or even some term policies might make good candidates if they otherwise fit the criteria, he said. The terminally ill don't find takers for life-settlement transactions, whatever their age.

"That's a viatical settlement, by definition," he added. "We deal with people who no longer have a need for life insurance--maybe because they have sold a business or they are divorced or they had an estate tax issue that doesn't exist anymore.

"But there are circumstances where the cash value of a life insurance policy may not be anywhere near its market value, given the age and health of the policyholder."

At present, two companies dominate the marketplace for life settlements--Coventry Financial, a unit of Coventry Financial Group of Fort Washington, Pa., and Viaticus, an affiliate of the big Chicago-based insurer CNA Financial Corp. Neither deals directly with policyholders; instead they work through a network of professionals around the country including attorneys, accountants and life insurance agents. (Both offer additional information on life-settlement transactions via Web sites at <http://www.coventryfinancial.com> and <http://www.hinetworth.com>.)

These and other players in the life-settlement marketplace price their deals by weighing the present value of the premium payments due to life expectancy against the death benefit and cash values and loans, if any. In effect, they bet on the payoff, and they hedge the risk by investigating the medical history of the seller.

As for the tax consequences to the seller of a policy in a life-settlement deal, Cavalier issues a valuable caution: You may well owe either ordinary-income or capital-gains taxes on any such transaction, so don't go into one without expert advice.

"You can't let greed be your reason for doing it," he said. "You can't need the policy, and you have to find someone who knows the market. But that life insurance policy may have a market value that has nothing to do with its cash value."

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