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CONSUMER ADVISORY: WHAT YOU SHOULD KNOW BEFORE YOU SELL YOUR LIFE INSURANCE POLICY

There has been growing discussion by consumers about selling their existing life insurance policies. Before you decide to sell your policy, there are a number of things you should consider. This consumer advisory will give you some tips to think about while you are making your decision. The most important tip is to meet with your financial advisor, accountant, estate planner or tax advisor before you sign anything. They will be in the best position to advise you of the tax and investment implications of your decision.

Arrangements to sell insurance policies have a number of different names. They are most frequently referred to as viatical settlements or life settlements. In these agreements, the owner of the policy sells the policy to a life settlement company, sometimes referred to as a viatical settlement provider, for cash. The amount paid will be more than the policy's cash surrender value but less than the death benefit. These arrangements were developed initially for people with life threatening illnesses; however, they are now also being used when:

- The life insurance policy is no longer needed or wanted.
- The premium payments have become unaffordable.
- The policyholder is considering surrender of the policy.
- The policy is about to lapse.
- There is a change in estate planning needs, financial circumstances or life circumstances (such as divorce or death).
- The policyholder needs funds to pay for healthcare or long-term care.

In these transactions, the existing policy is purchased by a life settlement company that either holds the policy to maturity, pays the required premiums and collects the net death benefit or resells the policy – or sells interests in multiple, bundled policies – to hedge funds or other investors.

Maryland law requires that brokers who sell viatical settlements and life settlements have a license to sell life insurance from the Maryland Insurance Administration (MIA) and be registered with the MIA. A list of registered brokers and settlement companies is available on the MIA's web site at www.mdinsurance.state.md.us.

Remember, the broker works for you and has a duty to look out for your best interest.

FREQUENTLY ASKED QUESTIONS

How much money will I get if I enter into one of these arrangements?

The amount of money you receive will depend upon a number of factors, including your age and medical condition, the type of life insurance policy (e.g., universal life, whole life, term), amount of the death benefit, dollar amount of premiums necessary to keep the policy in force, and amount of compensation the life settlement broker receives. You should contact several brokers or companies before selling your policy in order to obtain the best offer. If you have a life insurance policy with a cash value, the amount you receive should be greater than the cash surrender value of your policy. You should contact your insurance company if you do not know the cash surrender value of your policy.

Will my privacy be maintained?

During the application process, you will be required to sign an authorization releasing your medical and other personal information to potential buyers, buyers who are the life settlement companies. You may also periodically be asked to update your health status information. Once this information is obtained, it may be shared with other parties, including lenders or third party investors. Be sure to carefully read your application, contract and all other material you receive to determine what procedures the life settlement company uses to maintain and protect the confidentiality of your personal information.

Before you agree to the release of your medical and personal information, know who is involved in the transaction and check them out thoroughly. If you negotiate through a life settlement broker, find out the name of the life settlement company involved in the transaction. Inquire about the privacy policy of all parties involved in the transaction.

Are there other options available besides selling my policy?

Maryland law requires that the broker or life settlement company disclose alternatives to the settlement contract including accelerated death benefits, policy loans or the surrender of the policy for its cash value. Before agreeing to sell your policy, you should discuss all of the options with a financial advisor to see which is the best for you.

Are the proceeds I received taxed?

You may incur tax consequences from the transaction. You should consult a tax advisor and/or financial advisor to review any potential tax consequences from the transaction before you sign anything. The sale of your policy may also impact your ability to receive state or federal public assistance including Medicaid. Also, you should ask whether any of your creditors could make a claim against your settlement. You should talk with the government agency providing you assistance to see if the settlement will impact your assistance.

What are the transaction costs?

The commissions paid to the brokers and other financial professionals involved in the transaction can be as high as 30%. Ask your broker what his compensation is for his role in the transaction and what other parties are receiving commissions. Brokers are also required to disclose to you all offers, counter-offers, acceptances and rejections relating to the sale of your policy within 72 hours of their receipt by the broker. Under Maryland law, brokers are required to explain in writing within 72 hours before the contract is signed by all parties, the amount of the broker's compensation and how it is calculated. Also, you should be careful when brokers pressure you to use the proceeds from the settlement to purchase another insurance product. In many instances, the broker will be able to earn two commissions from this type of arrangement.

Will I be able to purchase another life insurance policy?

If you are considering buying a new policy with the proceeds of the life settlement, you will need to determine whether you will be able to get a new policy with equivalent coverage – and at what cost. Your old policy will still be in force and may affect your ability to get additional coverage. Even if you can get a new policy, you may have to pay higher premiums because of your age or changes in your health status. If your goal is to retain coverage but lower the premiums you pay or otherwise obtain different features, you might want to consider options such as reducing your existing amount of policy coverage or making a "1035 Exchange."

The Internal Revenue Service allows you to exchange an insurance policy that you own for a new life insurance policy insuring the same person without paying tax on the investment gains earned on your original contract – which could be a substantial benefit. Because this transaction is governed by Section 1035 of the Internal Revenue Code, it is called a "1035 Exchange." But there are other factors you should consider when deciding whether to exchange your policy, including potential loss of death benefits for your beneficiaries. For more information, consult your financial or tax advisor.

What if I change my mind?

By law, you have the right to change your mind and rescind the transaction within 15 days of receiving the cash payment. If you change your mind within 15 days, all money must be returned by all parties.

Should I do anything to protect my money when I agree to sell my policy?

Require the broker to put your settlement proceeds into an independent escrow account to protect your funds during the transfer.

STRANGER ORIGINATED LIFE INSURANCE (STOLI) ARRANGEMENTS

In addition to being asked to sell existing life insurance policies, some consumers between the ages of 65 and 85 are being asked to enter into arrangements in which the consumer agrees to purchase a new life insurance policy using a loan to pay some or all of the premium for the policy during the first two years. In these arrangements, if the insured dies during the first two years, the insured's beneficiary collects the benefit. At the end of the two year period, most of these arrangements give the insured two options:

1. Keep the policy by paying back the loan, plus interest and any applicable fees, and continue to pay the policy premium; or
2. Sell the policy to the life settlement company.

Option two is generally the one chosen since it is most beneficial to the policyholder in that the policy will be purchased for its fair market value. These arrangements are stranger originated life insurance (STOLI) arrangements. They may also be referred to as Investor-Owned Life Insurance; Charity-Owned Life Insurance; Speculator-Initiated Life Insurance;. "zero premium life insurance"; "no cost to the insured plans" or "new issue life settlements." Consumers who enter STOLI agreements must be certain that they do not need this or any other life insurance since entering this type of agreement will clearly affect your ability to purchase additional life insurance. These policies are generally owned by investment groups and the investment revolves on the calculation of the life expectancy of the insured.

BEFORE entering into these arrangements, it is important that the consumer understand the terms of the arrangement as well as the consequences of entering into such an arrangement.