

Wall Street Journal – Source of Cash for Seniors Is Drying Up

November 13, 2008 - Older adults turning to the "life settlement" industry to help them through tough times are finding that this popular source of quick cash is getting harder to tap.

Life settlements, in which people sell their life-insurance policies to investors in exchange for a lump-sum payment, were a \$12.2 billion business in 2007, according to Conning Research & Consulting Inc. in Hartford, Conn. Despite regulators' concerns about the industry's high fees, opaque nature and aggressive sales practices, that figure is more than triple the amount of just three years earlier. The growth, in part, reflects the fact that retirements have been stretching longer -- and nest eggs shrinking faster -- than many retirees ever imagined.

Selling Your Life Insurance Policy

The "life settlement" industry—in which people sell their life-insurance policies to investors in exchange for a lump-sum payment—has grown rapidly over the past few years, attracting criticism for high fees, a lack of transparency and aggressive sales practices. But now, some people who need cash are finding it difficult to sell their policies.

- Hit hard by the credit crunch, some big investors in life settlements have disappeared, dropped out of the market or limited their purchases.
- A set of life-expectancy tables many investors rely upon to help determine the prices they're willing to pay for policies were recently revised. On average, life expectancies have been extended by some 15% to 20%—which means that investors are likely to have to wait longer to collect benefits and pay more in premiums.
- Brokers say many deals negotiated this summer have since fallen through, only to be resurrected at lower prices, while other policies that were marketable only recently have no buyers.
- Policyholders in need of cash may be able to take out a loan against a policy. Those with a terminal illness may even qualify to receive the death benefit early.

Source: WSJ research

More recently, however, fallout from the credit crisis, coupled with a critical change in September in how sales of life-insurance policies are priced, means that several buyers of such policies -- who make their money by pocketing the death benefit when the initial policyholder dies -- have either pulled out of the market or scaled back their purchases. The buyers that remain are, in many cases, offering lower prices. And that is cutting off a source of cash for the growing numbers of older adults who rely on such sales to shore up shaky finances.

"Several seniors we've transacted with lately have suffered tremendous losses in their retirement savings and seen substantial equity value in their homes wiped away," says Mark Goode, chief executive of the Peninsula Group in Washington, which buys life-insurance policies for institutional investors. "Many sellers simply need the cash. Their question today is: 'How quickly can we close?'"

The increasingly common answer: not very soon, if at all. Richard Hess of Lancaster, Pa., recently approached Milestone Managers & Providers in Manheim, Pa., about selling his \$100,000 policy to raise "a little extra money." The 66-year-old was told he had missed his window of opportunity.

"Six months ago we might have had a buyer," says Kristian Armstrong, chief executive of Milestone, which specializes in buying policies with death benefits under \$1 million. "But as it stands now, 66-year-olds are typically not going to get anything."

Big Investors Flee

Capital to purchase life-insurance policies is less plentiful than it was just a few months ago. Hit by the credit crunch, some big investors in life settlements, including hedge funds such as London-based BlueCrest Capital Management, have dropped out of the market or are limiting their purchases, industry observers say. Mr. Goode at the Peninsula Group estimates that "the number of active funders has been reduced by half over the past 12 to 18 months."

At National Financial Partners, a nationwide network of advisers specializing in life insurance, executive benefits and financial planning, commissions and fees from life settlements fell 28% in the first nine months of the year. BlueCrest didn't return a call for comment.

But the credit crunch isn't the only problem. In mid-September, a set of life-expectancy tables many investors use to help determine the prices they're willing to pay for policies were revised by one of the major firms that calculates them, 21st Services in Minneapolis. The tables now indicate policyholders are likely to live longer -- an average of about 20% longer for men and 15% for women -- than previously expected. (The exact change varies by age, gender, smoking status, and health.)

This means investors are likely to have to wait longer to collect those benefits. They're also likely to have to pay additional premiums -- an extra expense that's driving down the amount they're willing to pay for new policies.

Regulators have long expressed concerns about the life-settlement industry. While a cash windfall may be appealing, hidden costs -- including high fees and potential tax liabilities -- can substantially erode what policyholders receive from these deals.

Life-settlement brokers often pocket the lesser of 6% of a policy's face value or 30% of the gross sale price. While heirs who inherit life-insurance benefits pay no income tax on their payouts, those who sell their policies are subject to income tax on at least some of their gains. (The rest may qualify for capital-gains tax treatment. But because the Internal Revenue Service has yet to issue a ruling on the tax treatment of life settlements, this "remains uncertain," says Stephan Leimberg of newsletter publisher Leimberg Information Services.)

There are other risks, too. Those who sell a policy only to later decide they need additional insurance may find they've used up all of the coverage a carrier will sell them. And because the market isn't generally transparent, it's often hard for those who sell policies to know whether they're getting a good price.

Still, with a life settlement, policyholders can typically net more than is available by surrendering a policy to the insurer for a lump-sum payment. Before selling, you should consult a financial planner, an accountant, or an attorney. Alternatively, if your policy has cash value and you prefer to keep it -- or can't find a buyer -- there may be ways to borrow against it or withdraw funds from it.

To get access to more cash, you can ask your insurer to scale back the death benefit. "By restructuring the policy, you may be able to draw out any cash that's no longer needed to support the coverage," says Gary Cotter, a certified financial planner at Cotter Financial in Sun City Center, Fla. But there are caveats. Under some circumstances, loans or withdrawals can trigger tax bills, Mr. Cotter says. Moreover, if you deplete your policy's cash value, your coverage will lapse. Ask your insurer to project the impact of a withdrawal or loan, he advises.

In some situations, you may even fare better than you would with a life settlement. Under New York Life Insurance Co.'s Access Plus program, for example, clients of the insurer who are 65 or older and meet certain health requirements may be able to borrow more than a policy's cash value. Borrowers must repay the principal and interest from their policies' death benefits. Those with a terminal illness, meanwhile, may be eligible to receive the policy's entire death benefit. They will typically owe ordinary income tax on the gains from such a payment, known as an "accelerated death benefit," Mr. Cotter says.

While the funding drought may reverse when the credit crunch recedes, industry insiders say the higher life-expectancy estimates are likely to continue to weigh on prices. "Due to the revisions in the tables, it's hard for buyers to even assess what a policy is worth," says Jonathan Forster, a partner at law firm Greenberg Traurig, which has represented investors in these transactions.

Renegotiating Deals

This has left cash-strapped seniors at the mercy of yet another market beset by falling prices. Brokers say many deals negotiated this summer have since fallen through, only to be resurrected at lower prices.

Larry Rybka, president and CEO of Akron, Ohio, brokerage firm Valmark Securities, says investors canceled 12 of the 18 contracts his firm was closing at the time the life-expectancy tables were revised. Mr. Rybka says his brokers were ultimately able to secure deals -- at much lower prices -- for nine of the 12 transactions.

One of those clients recently negotiated the sale of a policy for 60% less than he was offered last summer, when he first shopped the policy to investors. Although reluctant to

sell, the client -- a man whose business is now on the rocks -- can no longer afford to pay the premiums, Mr. Rybka adds.

Skip Santori, a financial planner at Santori & Peters in Monroeville, Pa., represents an 82-year-old woman who has been trying to sell two \$750,000 policies since August. Two years ago, when Mr. Santori handled the sale of an identical policy for the same client, she received \$145,000. This time, the winning bid came in at \$120,000 per policy. But when the life-expectancy tables were revised, that deal fell through.

While a new buyer recently offered \$83,000 for each policy, this company, too, has pulled the offers, Mr. Santori says. "They said their liquidity froze up."

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