

# Serving Affluent Clients: Connecting the Dots Among Estate Planning, Philanthropy, and Life Settlements

by Sean McNealy and Marlene Frith

As wealth, inheritance, and retirement take center stage for aging Baby Boomers, financial advisors and insurance professionals are positioning their practices for this highly desirable market segment. Building a client base of affluent individuals may be the Holy Grail for some financial professionals and wealth managers. But, serving them requires sufficient knowledge of a wide range of products and services and understanding wealthy seniors.

Therefore, financial professionals serving this demographic must be capable of connecting the dots with sufficient knowledge to deliver an integrated wealth management solution that fits each client's objectives. Recognizing the role that life settlements can play in addressing estate planning challenges and maximizing charitable giving objectives is part of the required knowledge base for today's successful advisors and wealth managers.

From an estate planning perspective, elderly parents of retiring Baby Boomers have already passed through the wealth accumulation and wealth preservation phases. They are engaged in the distribution and transfer phase or are on the cusp of it. Their concerns revolve around who should receive their assets and how and when those assets should be distributed. Decisions about charitable giving, maximization of distributable wealth, and tax considerations are major issues for seniors during the transfer phase. A life insurance policy is often the cornerstone of the estate plan -- the trustee for which may be a family member, a bank trust officer, a trust company, an accountant, or an attorney.

That said, financial professionals should be aware that there is mounting evidence that some trustees are not reviewing or

managing trust-owned life insurance policies properly. A survey conducted in 2003 by *Trusts & Estates* magazine revealed that nearly 84% of advisors acting as trustees said they did not have stated guidelines and procedures for handling the review of life insurance. Supporting this statistic is the number of trust-owned life insurance policies that are settled in the secondary life insurance market. These policies are usually recommended for a life settlement after the insurance agent determines that the policy is no longer performing as expected and may require infusions of cash to keep it in force.

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A recent case shows how a bank trust officer was able to rely on the expertise of an insurance agent. During an annual review, the agent discovered that a \$2 million trust-owned life insurance policy would require a substantial increase in premium payments in order to stay in force. But, the grantors were unwilling to spend more money to maintain the policy. The agent recommended that they explore a life settlement and apply the proceeds toward the purchase of a replacement policy. The parties accepted a settlement of \$460,000 and used the proceeds to purchase a \$2 million policy with lower pre-

mium payments. Needless to say, the clients were quite pleased with the solution and the bank trust officer felt he had upheld his fiduciary duty as a trustee – thanks, in large part, to the insurance agent's expertise.

Insurance agents are usually more knowledgeable in evaluating policy performance and identifying situations in which a life settlement may be the most suitable solution. But, other professionals who serve as fiduciaries or gatekeepers to the wealthy are beginning to recognize the need to expand their knowledge about life settlements and the importance of interdisciplinary collaboration due to the complexity of life insurance and its role in estate planning.

Charles Ratner, insurance industry expert and prolific author, wrote last year in *Trust & Estates Magazine* that, "Life settlements are having a major impact on estate, financial, and insurance planning. Don't be surprised to see more life settlements as people realize that their balance sheets and income statements are losing the race against longer life expectancy." According to internal statistics by Advanced Settlements Inc., the typical life settlement transaction involves a male with an average age of 78 and a life insurance policy valued at \$1.8 million.

When it comes to affluent senior clients, financial professionals must not underestimate the importance of philanthropy in estate planning. Affluent seniors are among the most generous groups in the nation. In addition to motivating factors, such as giving back to society and leaving a legacy, being involved with charitable organizations is part of the social fabric in the lives of many seniors.

The connection among seniors, wealth, and philanthropy is illustrated in recent data and surveys. IRS data indicates that almost 18.5% of recent estate tax returns reported a charitable contribution -- the average of which was nearly \$1.3 million. A recent Bank of America survey of 30,000 high net-worth households revealed that nearly 98% had donated to a charitable organization in 2005 and 61% served on boards of directors. The Bank of America survey found that the wealthiest 3% of American households were responsible for nearly two-thirds of charitable giving. Retired households own 48% more wealth and contribute 69% more to char-

itable causes than do non-retired households, according to a report issued last year by the Center on Wealth and Philanthropy at Boston College

With those statistics in mind, it is important for the financial professional to understand the client's charitable objectives and the best methods to achieve them. For example, the financial professional might discover two things during an estate planning review: The senior owns multiple life insurance policies, one of which is no longer needed to support the estate plan; and the senior wants to increase their charitable contributions. Rather than donating other assets in the estate to the charity, the senior may want to consider gifting the life insurance policy to the charity directly or pursuing a life settlement and donating the proceeds to the charity. In fact, a recent survey of insurance professionals conducted by Agent Media Corporation revealed that 20% of seniors chose to do a life settlement in order to donate the proceeds to charity.

A gift of life insurance appeals to a variety of donors because it is cost-efficient, provides a tax deduction for premium payments, and there is no erosion in payout due to administrative fees. For non-profit organizations with established procedures to accept and monitor them, gifts of life insurance can be a plus to their bottom lines as these policies reach maturity. However, as with the challenges in monitoring trust-owned life insurance policies, charities are often ill-equipped to understand the complexities of life insurance and incapable of conducting annual reviews. So, donated policies are sometimes surrendered to the carrier or allowed to lapse.

It is a well-known fact that life insurance companies rely on policies lapsing. In 2005, insurance companies reduced their exposure by \$1.1 trillion when nearly 20 million policyholders stopped paying premiums. In comparison, the industry paid death benefits on only 2.2 million policies, according to the Insurance Information Institute.

Charities that are struggling to manage insurance policies could request the donor's assistance in pursuing a life settlement, which generally averages three times the cash surrender value. Since cash is king to most charities, the proceeds could be

applied immediately to an endowment or other program to help achieve the donor's legacy while they are still living. Because the senior is accustomed to making annual premium payments on the donated policy, the charity could ask the donor to purchase a new policy with comparable premium payments and name the charity as beneficiary. That way, the charity would receive a full death benefit in addition to receiving an immediate cash infusion for the initial policy while the senior donor is still living. Of course, it is important to remember that there may be obstacles to a senior being eligible for additional coverage, such as changes in health, advanced age, and so forth.

It is a meaningful experience for charitable donors to see the results of their generosity during their lifetime, which can inspire increased giving. More than 58% of affluent households surveyed in the Bank of America study said they would give more to charity if they could see the impact of their gifts.

A question that often arises concerning the donation of life insurance policies to charities is, "For tax purposes, is it better for the donor to gift the policy to the charity, which later sells it in the secondary market or for the donor to sell the policy and donate the proceeds to the charity?" Because tax issues vary from person to person, it is important for policy donors to consult their tax advisor to weigh the tax ramifications.

Affluent seniors expect state-of-the-art products and services from their professional advisors. Financial services professionals, insurance agents, wealth managers, trustees, accountants, and attorneys will be called upon by Baby Boomers and their aging parents to help them navigate the wealth distribution and transfer stage of their estate plans. Understanding high net-worth individuals and offering creative solutions to complex problems will help the best and the brightest come closer to achieving the Holy Grail of the financial services profession. □

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*Sean McNealy is co-president of Advanced Settlements Inc. Sean can be reached at [sean@advancedsettlements.com](mailto:sean@advancedsettlements.com). Marlene Frith, who is director of Marketing and National Accounts for Advanced Settlements, can be reached via email at: [marlene@advancedsettlements.com](mailto:marlene@advancedsettlements.com).*