

The Business Uses for Life Settlements

WHITE PAPER



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Understanding Business Uses for Life Settlements

Key man policies in an era of mergers and acquisitions

During the past year, we have heard from a number of producers who are seeking to build their Life Settlement practice by expanding their referral networks. Specifically, many insurance professionals and financial advisors are recognizing that CPAs and attorneys are an excellent source for Life Settlement referral cases. The most recurring question is: “How can I convince CPAs and attorneys that a Life Settlement could be a viable option for their clients under the right circumstances?”

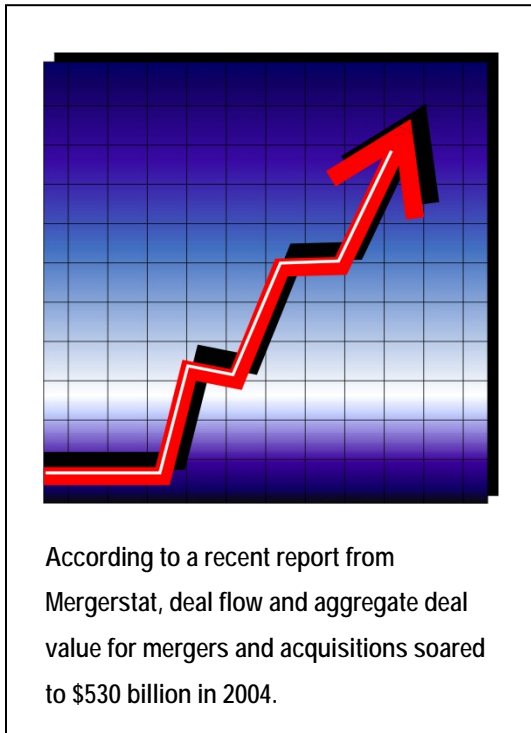
To answer that question, it is important to first determine whether the CPA or attorney has a corporate practice, or one geared toward individuals. For CPAs or

attorneys who serve high net worth seniors, the connection or application between their practice and Life Settlements could be considered a direct one. However, for CPAs or attorneys who have large corporate clients, the application of Life Settlements in the normal course of business may not be readily apparent – but there are business uses for Life Settlements of which they may not be aware. Offer to take the CPA or attorney to lunch in order to get a



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better understanding of their practice. Then, be prepared to introduce them to the ways in which Life Settlements could be applicable and how it would be in the best interest of their clients to be aware of the option.



One of the most common business applications for life settlements relates to key-man policies being held by a company and insuring the life of a retiring or departing older executive. As opposed to the traditional option of simply surrendering a policy for CSV, a life settlement can be used to obtain additional proceeds for the company which can be used in a variety of ways

(for example, to eliminate company debt, to free up funds for capital investment, or even to create a severance package for the departing key-man). This outstanding new option is an excellent way of creating "found money" from a resource which might otherwise go untapped.

Key-man insurance has been around since the 1960s and has been used in a variety of ways, since that time. Venture capitalists, for example, might require key-man insurance on the intellectual capital behind a high-tech startup, where one individual's creative or engineering skills are paramount to the venture's success. Many large corporations insure the bulk of their management staff in order to protect themselves from the rough transitional phases associated with the loss of a key employee.

Corporations involved in merger and acquisitions (M&A) can often benefit from the secondary life insurance market by pursuing the highest possible value for key-man policies on departing senior executives. As the economy continues to pick up speed, the time is ripe for corporate expansion. In their quest for scale economies, to seek an increase in

market share in core lines of business, or even to diversify into new product markets and regions, corporate M&A activity is expected to increase.

According to a recent report from Mergerstat, deal flow and aggregate deal value for mergers and acquisitions soared to \$530 billion in 2004, up from \$312 billion during the same period last year. CPAs who work with financial advisors in merger and acquisition activities may find opportunities to address key-man life insurance policies on departing executives during the due-diligence phase of M&A activities.

When a company that owns key-man insurance on older executives is sold or goes into bankruptcy, CPAs should assess whether these policies might qualify for a life settlement. The proceeds from liquidating those policies on the secondary market can be leveraged as a corporate asset during settlement negotiations or can be used to pay off creditors during bankruptcy procedures.

Case Example

Advanced Settlements recently transacted a life settlement that involved a buy-sell agreement for a family owned

business. The case involved two elderly sisters who were major company shareholders. The company needed an infusion of cash to pay down debt and increase shareholder dividends. The elderly owners held a combined total of \$3 million in life insurance that was purchased to fund a buy-sell agreement.



Family owned business resolves liquidity issues through life settlement transactions on two key man policies.

The older sister, age 87, carried a \$1 million life insurance policy with a cash surrender value of \$7,297. The younger sister, age 82, had a \$2 million policy with a cash surrender value of \$141,262. Their life insurance agent recommended a life settlement on each policy as the

solution to addressing the company's financial objectives.

Advanced Settlements was brought in to broker the policies on the secondary market in pursuit of the highest possible life settlement. The life settlement on the older sister's \$1 million policy was \$394,262 (or \$386,965 more than the cash surrender value), and the life settlement on the younger sister's \$2 million policy was \$300,000 (or \$158,738 beyond the cash surrender value.) At the end of the day, the company garnered an additional \$545,703 in "found money" from liquidating the buy-sell agreement that could be used to address the company's immediate financial needs.

Life settlements are gaining momentum in all areas of the financial services profession. As reported in the June 2004 issue of *California Broker Magazine* in an article entitled "**Life Settlements: A Cottage Industry No More**," the life settlement industry has entered most areas of the financial services marketplace and is expected to continue to grow rapidly. Favorable regulatory action, investment banking activities, and an Ivy League study extolling the

benefits of the secondary market for life insurance policies were all cited as reasons that this emerging marketplace is now being embraced by most wealth management professionals.

As "centers of influence" for qualified seniors who may be candidates for life settlements, CPAs and attorneys play an important and strategic role in the decision-making process. As such, they should take time to become familiar with Life Settlements and how they can be used as an effective wealth management tool for their individual senior clients and their business clients as well.

(Note: Some or all of the proceeds of a life settlement may be taxable under federal or state income tax laws. Advice from a professional tax advisor is recommended. Actual results will vary. The average purchase price obtained by owners is approximately twenty-two (22) percent of the face amount of a qualified life insurance policy).

About Advanced Settlements

Advanced Settlements, Inc. is a respected industry leader in the life settlement marketplace. Through a network of approximately 15 highly-capitalized funding institutions, the company obtains multiple offers on the secondary market in pursuit of the highest possible life settlement for the senior policyholder. Having transacted life settlements totaling more than \$1.5 billion in policy face value, executives with the company have provided this powerful wealth management tool to high net worth seniors since the inception of the industry in 1998.