

# *Life Settlements* *and* *Charitable Giving*

## **“Giving While Living”**

Life Settlements provide high net worth seniors with the opportunity to realize their philanthropic legacies during their lifetime.



Charities that may have been forced to let donated policies lapse may find a new revenue source in Life Settlements.



[www.advancedsettlements.com](http://www.advancedsettlements.com)  
1-800-561-4148

*Note: Advanced Settlements, Inc. is a licensed broker in most states, but is not licensed in all states where licensing is required.*

Intended audience for this White Paper:

- **Financial planners**
- **CPAs**
- **Financial advisors**
- **Estate Planners / Attorneys**
- **Brokers / registered reps**
- **Producers / Agents**
- **Planned Giving Officers**



How to apply this information:

- **Counseling High Net Worth Seniors** – Financial planners, CPAs, estate attorneys, brokers, etc., will want to be aware of this information in order to inform their clients of Life Settlements as an option to achieve their charitable giving objectives.
- **Financial Advisors to Foundations and Charities** – Those whose clients include non-profit charitable organizations will want to educate planned giving executives and foundation officers of Life Settlements as an alternative to letting donated policies lapse.
- **Civic-Minded Producers / Agents** – Financial and insurance professionals who are actively engaged in their communities, who sit on boards and who raise funds for non-profit organizations will want to be aware of Life Settlements as a possible recourse to donated policies that may require expensive policy and premium maintenance.
- **Planned Giving Officers** -- Those who are employed by non-profit organizations and foundations as fundraisers and planned giving officers will want to be aware of the opportunities associated with increasing revenue through Life Settlements.

## Giving While Living

Financial professionals, estate attorneys and other advisors who serve high net worth clients are often challenged to stay abreast of estate planning strategies and tax laws. As the economy fluctuates, tax laws change and personal wealth shifts from one generation to the next, the demand grows for estate planning professionals who stay on the cutting edge of wealth management strategies.

This article provides a comprehensive analysis and the future outlook for the growing connection between Life Settlements and charitable giving. Specifically, we will explore:

- the use of Life Settlements as a new tool for estate planning and charitable giving;
- the projected \$41 trillion intergenerational wealth transfer and its impact on charitable giving;
- A brief summary of the article published in the American Bar Association's Real Property, Probate and Trust Journal describing the emergence of the secondary market for life insurance policies are pro-consumer;
- the opportunity for financial advisors to identify charitable giving facilitated via Life Settlements;
- Life Settlements as a pro-consumer financial product; and
- the projected growth in both the Life Settlement industry and in planned charitable giving.

The secondary market for life insurance policies has now become an industry unto itself and has earned a place among mainstream investment portfolios now that rating agencies such as Moody's and A.M. Best have entered the picture regarding the securitization of investments with the use of life insurance policies sold on the secondary market.

According to *The Wall Street Journal* (April 30, 2004), Merrill Lynch was recently involved in a ground breaking bond sale by arranging the private placement for \$70 million in bonds backed by life insurance policies rated by Moody's Investors Service. This is good news for the life settlement industry since the nature of investment banking is founded upon the stability of assets and longevity in the realization of returns.

At Advanced Settlements, Inc., our objective in providing this free white paper is to educate those involved in planned giving about the use of Life Settlements as a tool to assist high net worth seniors in realizing their philanthropic legacies while still living.

Furthermore, we believe it is important for planned giving officers and development staff of charitable organizations to be aware of Life Settlements as an alternative to letting donated policies lapse.

### Life Settlements – A New Tool for Estate Planning and Charitable Giving

With charitable giving expected to dramatically increase as wealthy seniors seek to identify their philanthropic legacies, estate planners and financial advisors now have a new wealth management tool – Life Settlements -- to assist their clients in achieving their charitable giving objectives. Through a Life Settlement, a senior at least 70 years of age can sell a life insurance policy on the secondary market for a far greater amount than the cash surrender value, and then receive a tax deduction on donating the proceeds to their favorite charity.

Not only does the transaction simplify the donor's wish to see their contribution immediately benefit a favorite charity, but the non-profit organization that would otherwise have received the contribution as a donated life insurance policy is not faced with making premium payments and other administrative activities associated with donated policies. Furthermore, the charity has an immediate infusion of cash that can be leveraged and maximized through the organization's investment portfolio.

*Because of the role they play as financial advisors to high net worth seniors, estate planners may have an exclusive opportunity to identify the role Life Settlements can play in achieving charitable giving objectives.*

### The Projected \$41 Trillion Intergenerational Wealth Transfer and Its Impact on Planned Giving

*Over the next 50 years, \$41 trillion is projected to change hands, with \$6 trillion going to foundations and non-profit charitable organizations. With donated life insurance policies comprising a sizable portion of planned giving, financial professionals are examining the role Life Settlements can play to help foundation officers maximize planned giving and leverage the proceeds from Life Settlement transactions.*

According to a study released by Boston College's Social Welfare Research Institute (SWRI), the single largest intergenerational transfer of wealth in the history of our nation will take place over the next 50 years. The projection, which was originally published in the 1999 report entitled, *Millionaires and the Millennium: Prospects for Wealth Transfer and a Golden Age of Philanthropy*, indicates that \$41 trillion would be transferred via the estates of high net worth seniors – with \$6 trillion expected to go to charitable foundations. The prediction was subsequently validated in 2003, and SWRI director Paul Schervish stated that confirmation of the projection “should come as a great relief to universities and charities across

the country who expanded their development offices and overhauled their staff in response to the \$6 trillion prediction.”<sup>1</sup>

The impact of this report from a practical perspective has been impressive and staggering. First, it was officially adopted by the Council of Economic Advisors, incorporated in analysis by the Congressional Budget Office, and favorably received by the Bureau of Labor Statistics. Secondly, it caused financial firms and estate planners to add intergenerational themes and philanthropy to estate and wealth management services. Furthermore, philanthropic services companies and software vendors have entered the market. One software application service provider (ASP) company, known as the Foundation Source, opened in 2000 and offers a web-based turnkey solution for financial advisors and clients that provides complete back-office administration and compliance services.<sup>2</sup> According to their brochure, their turnkey approach “lets any financial advisor include private foundations as a key wealth management tool for their affluent clients.”

### Recognizing an Opportunity for Charitable Giving via Life Settlements

Estate planners and financial advisors – due to their consultative roles -- are often gatekeepers of philanthropic giving, and as such, they may have an exclusive opportunity to identify the role Life Settlements can play in charitable giving. Because high net worth seniors rely on the advice of wealth management professionals who have the broader picture of the client’s estate planning objectives, tax implications and charitable giving habits, these professional advisors have an opportunity to assist the client in maximizing planned giving by recommending a Life Settlement in certain circumstances.

Consider this scenario. A wealthy senior is thinking of lapsing a policy or cashing it in for the surrender value because the policy is no longer needed for its original purpose which was to assist his heirs in paying estate taxes upon his death. In such a situation, the estate planner will want to discuss with the client the idea that instead of giving up the policy, he consider selling it for its fair market value on the secondary market. The proceeds could then be used to satisfy the client’s philanthropic legacy while decreasing his tax burden. Furthermore, the cash from the tax savings could then be used to purchase a replacement policy more suitable to the client’s current lifestyle or a policy that more closely parallels his current estate planning objectives.



*“ ... to provide ladders  
upon which the aspiring  
can rise.”*

--- Andrew Carnegie on  
philanthropic giving

### Helping Potential Candidates for Life Settlements Identify a Philanthropic Legacy

Contemporary philanthropy as it is practiced today has its roots in the charitable giving philosophies of industrial magnates such as Andrew Carnegie, fellow industrialist John D. Rockefeller and investment banker J. P. Morgan. These icons from the industrial age understood that the possession of wealth carried with it societal obligations, and Carnegie implored the wealthy to view their personal fortunes as being held in trust for the public

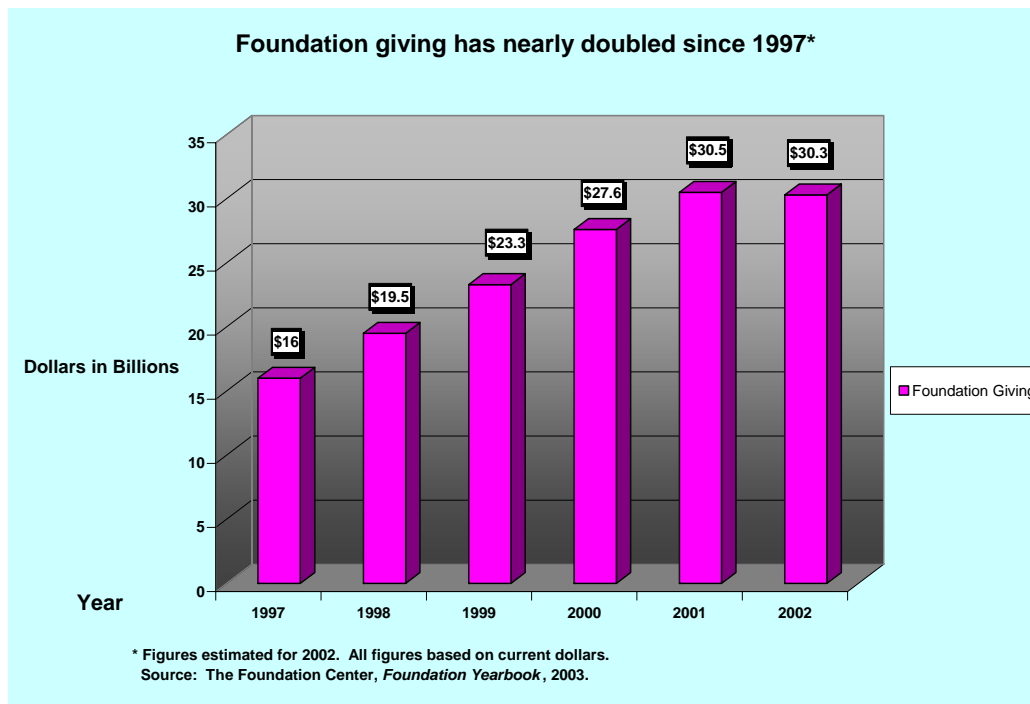
good. In his famous essay, “The Gospel of Wealth,” Carnegie suggested that in establishing philanthropic foundations, that the distinction be made between giving for the relief of immediate needs (charity), and philanthropy in order “to provide ladders upon which the aspiring can rise.”

The charitable sector is growing and constitutes over six percent of the nation’s economy. In 1999, there were almost 1.3 million tax-exempt organizations in the United States, nearly 700,000 of which are publicly supported charities.<sup>3</sup> In 2002, the most recent year for which data are available, total assets for the nation’s nearly 65,000 foundations equaled an estimated \$435 billion.<sup>4</sup>

Last year, Americans claimed \$134 billion in tax deductions for charitable contributions. 30.2% of all returns, the highest number recorded since the tax code was rewritten in 1986, included write-offs for donations.

In general, an individual can deduct cash donations made to 501(c)3 charitable organizations as long as the donations total less than fifty percent of his/her adjusted gross income with a five year carryover. The higher the federal tax bracket, the lower the after tax cost of the donation. (For example, an individual in a 38% tax bracket who makes a \$1,000 donation will derive a tax savings of \$386, thereby making the net cost of the donation \$614. However, an individual in a 15% tax bracket making the same donation will save only \$150, with a net cost of the donation being \$850.)

*(Note: This is provided for informational purposes only. Please be advised that Advanced Settlements does not provide tax advice. Advice from a professional tax advisor is recommended.)*



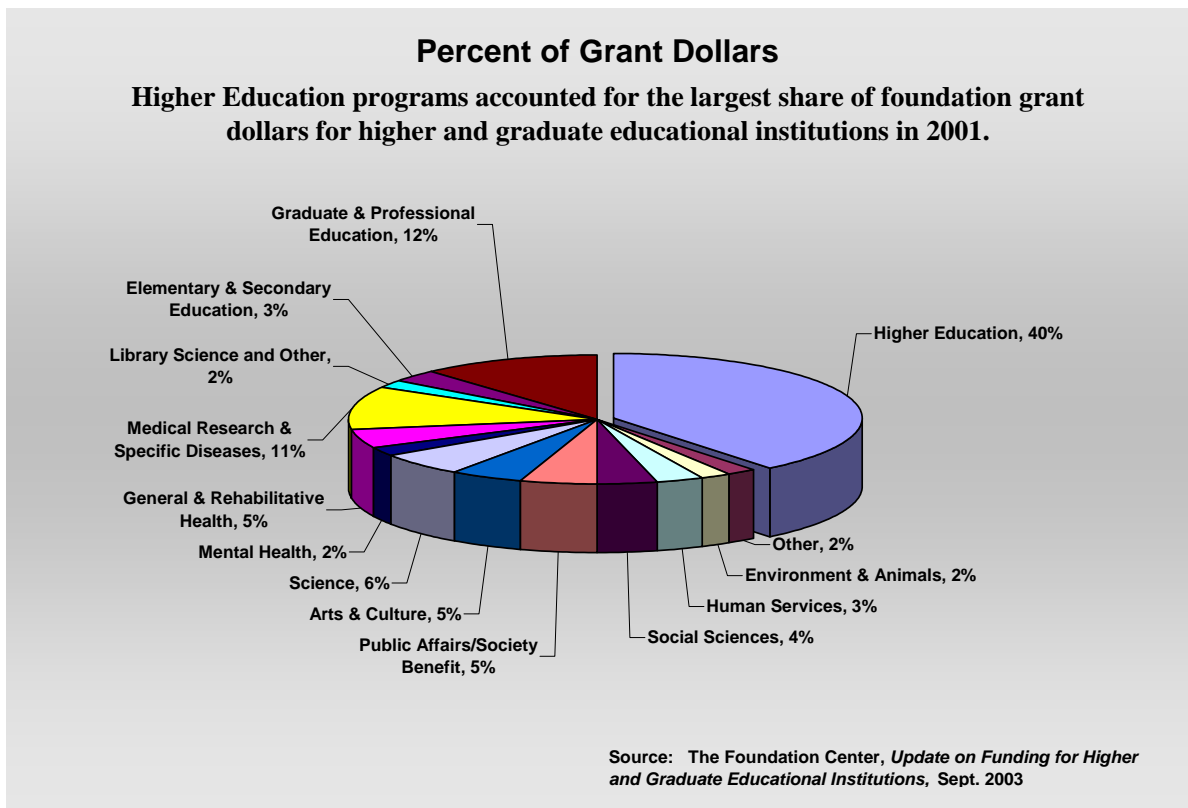
Where do the wealthy donate? An On-line survey tells us.

On behalf of Community Foundations of America and HNW, Inc., a company serving the high-net-worth marketplace, Harris Interactive surveyed 712 investors with annual household income of at least \$150,000 and \$500,000 or more in “investable” assets. The survey found that high net worth men preferred to donate to educational institutions, health-related charities and religious or faith-based organization; whereas wealthy women chose health-related charities, educational institutions and children and youth services.

### Educational Institutions and Community Foundations are Popular with Donors

Although there are numerous opportunities for charitable giving ranging from religious institutions to art museums, two of the most popular recipients of planned giving are universities and community foundations.

According to the Foundation Center’s most recent data and as illustrated in the accompanying chart, higher education programs accounted for the largest share of foundation grant dollars for higher and graduate educational institutions in 2001.



Charity Navigator ([www.charitynavigator.org](http://www.charitynavigator.org)) reported on a survey conducted by RAND's Council for Aid to Education (March 11, 2004). The survey noted that contributions to colleges and universities in the U. S. remained level during 2003 after declining for the first time in 2002. The study named the nation's top ten fundraising universities, in the order of dollars received, which are as follows:

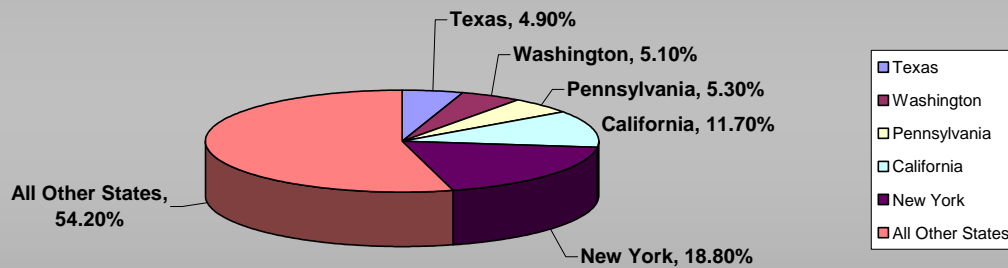
1. Harvard University
2. Stanford University
3. University of Pennsylvania
4. University of Arkansas
5. Johns Hopkins University
6. UCLA
7. Cornell University
8. University of Washington
9. University of Texas at Austin
10. University of Southern California

Community foundations make up one of the fastest growing sectors of philanthropy in the U. S. today. A community foundation is a public charity that manages funds and distributes the income to benefit the surrounding community. The Council on Foundations notes that there are more than 650 community foundations in the nation with \$29.7 billion in assets. Because community foundations build their endowments by pooling the contributions from many donors within a geographic region, donors derive a sense of accomplishment knowing their gift was part of a successful community initiative that otherwise could not be possible with their singular donation.

As reported by the Council on Foundations, other types of foundations (in addition to community foundations) include:

- Corporate foundations which are private foundations established by for-profit corporations but legally separate from the parent corporation;
- Family foundations, in which the original donor or the donor's family plays a significant role
- Independent foundations, which are private foundations, usually endowed by one source such as an individual's bequest
- Operating foundations, which are private foundations that use most of their income to provide charitable services or programs of their own, rather than making grants to outside organizations;
- Public foundations, which are public charities that operate significant grantmaking programs in addition to their other charitable activities.

**Foundations in five states accounted for close to half of 2001 giving**



**2001  
Total Giving = \$30.5 billion**

Source: The Foundation Center, *Foundation Yearbook*, 2003

**The Top 25 Community Foundations by Asset Size<sup>5</sup>**  
(As of January 30, 2004)

1. The New York Community Trust (NY)	\$1,550,847,559
2. The Cleveland Foundation (OH)	1,312,166,868
3. Marin Community Foundation (CA)	1,150,556,205
4. The Chicago Community Trust and Affiliates (IL)	1,018,291,992
5. The Greater Kansas City Community Foundation (MO)	686,126,000
6. The San Francisco Foundation (CA)	664,449,772
7. The Columbus Foundation and Affiliated Orgs. (OH)	628,139,633
8. Boston Foundation, Inc. (MA)	571,632,382
9. Communities Foundation of Texas, Inc. (TX)	562,427,000
10. California Community Foundation (CA)	560,490,721
11. Community Foundation Silicon Valley (CA)	539,652,366
12. Hartford Foundation for Public Giving (CT)	497,392,716
13. The Minneapolis Foundation (MN)	487,522,995
14. Peninsula Community foundation (CA)	478,503,157
15. The Saint Paul Foundation, Inc. (MN)	472,657,883
16. The Oregon Community Foundation	437,820,143
17. Peninsula Community Foundation (CA)	434,674,607
18. Tulsa Community foundation (OK)	391,754,735
19. The San Diego Foundation (CA)	385,898,000
20. Oklahoma City Community Foundation, Inc. (OK)	376,656,078
21. Community Foundation for Southeastern Michigan (MI)	318,823,250
22. Arizona Community Foundation (AZ)	315,133,904
23. The Greater Cincinnati Foundation (OH)	314,916,701
24. The Rhode Island Foundation (RI)	307,672,670
25. Omaha Community Foundation (NE)	302,376,086

## Forward Thinking Charities – Adapting To an Economic Downturn

The beginning of a recovery in the stock market in 2003 is expected to encourage modest overall growth in 2004 foundation giving, according to the Foundation Center. Close to half of the respondents to the Foundation Center's 2004 Foundation Giving Forecast Survey indicated that they expect giving to increase up to ten percent.

However, irrespective of the improved forecast, some charitable organizations are continuing to struggle to overcome the impact of the economic downturn following September 11, 2001. In order to maintain stable levels of giving or grantmaking to community causes during periods of diminished investment returns, foundations have had to draw down on their assets. As assets become depleted, the strength of their investment portfolio is negatively compromised.

### Thinking Outside the Box – Using Life Settlements on donated policies to provide immediate liquidity in order to avoid spending down assets

Some charitable organizations have reportedly let donated policies lapse due to premium maintenance and/or administrative review procedures. What these organizations apparently do not know is the fact that donated policies may qualify for Life Settlements if the donor is at least 70 years of age. With the donor's cooperation and willingness to provide routine medical records, the charitable organization can sell the policy on the secondary market and generate substantial revenue as opposed to letting it lapse and take a loss.

During unfavorable economic conditions when a charitable foundation may be faced with the need to spend down their assets, this would be a prime opportunity to conduct a review of donated life insurance policies to determine which policies could be prospects for Life Settlements.

“If they knew Life Settlements were an option, perhaps development officers would reconsider the practice of letting policies lapse,” commented one philanthropic consultant whose clients include numerous foundations, universities and other organizations. “Most development staff are not aware of Life Settlements, but I believe having knowledge of this new wealth management tool could help them make better decisions as it relates to managing their donated life insurance policies and donor acceptance programs,” he added.

### Taking a Second Look at Gift Acceptance Policies

Given the growing connection between Life Settlements and charitable giving, non-profit professionals may want to take a second look at their gift acceptance policies and procedures to include the role of Life Settlements. Items to consider might be:

1. Should the charity state in its gift acceptance policy a willingness to receive the proceeds from a Life Settlement (liquidity), in addition to or as opposed to

accepting ownership of a life insurance policy (which in some instances may require annual reviews, premium payments, and recordkeeping.)

2. Should the charity inform the prospective donor at the outset that in exchange for accepting a donated policy, that it may seek permission in the future from the donor to sell the policy on the secondary market if it appears the proceeds from the Life Settlement will help fulfill the donor's intended legacy more effectively than waiting to collect on the death benefit, i.e. "giving while living."

The American Bar Association's Real Property, Probate and Trust Journal describes the emergence of the secondary market for life insurance policies as pro-competitive and pro-consumer.

A study conducted by the Wharton School of Business in 2002 was subsequently published in the ABA Real Property, Probate and Trust Journal in December 2003. The article speaks to the emergence of a robust secondary market for life insurance as a relatively recent phenomenon and explains that prior to Life Settlements, "incumbent life insurance companies wielded monopsony power over the repurchase of their own policies."

As stated in the article, the flexibility offered by the secondary market for life insurance policies (via Life Settlements) gives a policyholder the ability to respond to changes in his life situation. Because of this new liquidity option for underperforming life insurance policies, the potential market for Life Settlements is estimated at close to \$100 billion.<sup>6</sup> The projected welfare gains earned by policyholders in 2002 from the exercise of life settlement options (calculated as the difference between the total surrender value of \$93.4 million and the total offer to policyholders of \$336.3 million) was \$242.9 million.<sup>7</sup>

The authors list a variety of "situations in which the secondary market sale of a policy by an eligible individual is welfare improving" such as:

- Premiums are no longer affordable
- The beneficiary for whom the policy was originally purchased is now deceased
- A key-man policy is no longer necessary because the business has folded
- The policyholder owns multiple life insurance policies and wishes to eliminate one
- The policyholder wishes to remove the policy from a trust or estate
- An increase in the liquidity of the policyholder's estate eliminated the need for the policy
- The policyholder wishes to donate highly appreciated assets to charity, but would be faced with liquidity constraints resulting from such a donation.

## Pro-consumer attitude in regulatory and legal circles

The newly approved amendment to the Viatical Settlement Model Regulation by a key committee of the National Association of Insurance Commissioners (NAIC) in March 2004 essentially clears the way for licensed life agents to transact Life Settlements in their state of licensure. This is viewed as a positive step for insurance agents, consumers, and the life settlement industry as a whole.

"The easing of barriers to entry into Life Settlements is perceived by some as pro-consumer," explained Tom Offutt, J.D., compliance director for Advanced Settlements.

The amended Model Regulation is expected to be approved at the NAIC's summer meeting in June 2004. Except for a few states that already have the availability of life producer licensing to do Life Settlements, other states that do not yet have it, will be in a position to consider the new Model, once approved. At least 21 states have adopted some type of life settlement regulation, and it is likely that this list will grow as Life Settlements gain in acceptance across the country.

In addition to positive regulatory activity, we see it as quite favorable that the Real Property, Probate and Trust Journal of the American Bar Association published the compelling study released in 2002 by The Wharton School at the University of Pennsylvania extolling the benefits of a secondary market for life insurance policies. Authors Neil Doherty, professor of insurance risk management at The Wharton School, and Hal Singer, senior vice president of Criterion Economics, conclude that the emergence of the secondary market for life insurance policies has been "pro-competitive and pro-consumer." The authors also urge lawmakers to design regulations that encourage – rather than dissuade – participation and investment in this secondary market.

## Summary

Both the Life Settlement and planned giving industries are expected to grow substantially over the next few decades, and understanding the link between the two will assist estate planners in determining whether this link can have a positive impact on the estate planning objectives of their high net worth senior clients.

The secondary market for life insurance policies has now become an industry unto itself and has earned a place among mainstream investment portfolios. As A.M. Best reported in January 2004, one securities firm was recently assigned a debt rating of "aa-" where Class A Asset-backed bonds were collateralized with nearly \$200 million in face value of life insurance policies (Life Settlements).

It is important to note that planned giving can be exceptionally complicated instruments to construct and execute, and they require the services of trained professionals – attorneys, accountants and other tax and estate planning professionals who are trusted advisors to the client and respected by the recipient charitable organization.

Furthermore, charitable organizations have gift acceptance policies that address the types of gift instruments they are willing to execute, so it is important that this information be explored at the outset during discussions with the client about the recipient of their philanthropic legacy. In addition, state laws govern the donation of life insurance policies as well as Life Settlement transactions, so it is important for the financial advisor to be well acquainted with the insurable interest rules that apply in the given situation.

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<sup>1</sup> <http://www.bc.edu/swri>, Press Release, Boston College Social Welfare Research Institute, *The Markets May be Down, But the Largest Intergenerational Transfer of Wealth in History is Still Coming to Town.*(January 6, 2003)

<sup>2</sup> [www.ambest.com](http://www.ambest.com), BestWire Services Press Release: *Ready-to-Fund Foundations Hit the Market*, (April 19, 2002)

<sup>3</sup> Testimony before the U. S. House Committee on Ways and Means by W. Josephons, Assistant Attorneys General, NY State Department of Law., (March 26, 2003.)

<sup>4</sup> *Chronicle of Philanthropy*, Foundation Assets Recover,(March 2, 2004)

<sup>5</sup> The Foundation Center (<http://fdncenter.org>)

<sup>6</sup> Neil A. Doherty, and Hal J. Singer, *The Benefits of a Secondary Market for Life Insurance Policies*, Real Property, Probate and Trust Journal, Volume 38, No. 3, Fall 2003, p. 453..

<sup>7</sup> See *The Benefits of a Secondary Market for Life Insurance Policies*, p 473.

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The primary target audience for Advanced Settlements, Inc. is an insured who is 70 years of age or older, has a life expectancy of less than 12 years and has owned a life insurance policy with a face value of \$250,000 or more for not less than 2 years.

About Advanced Settlements, Inc.

Advanced Settlements, Inc. is a respected industry leader in the Life Settlement marketplace. Through a network of up to 20 highly-capitalized funding institutions, the company obtains multiple offers on the secondary market in pursuit of the highest possible settlement for the policyholder. Having transacted Life Settlements totaling more than \$ 1 billion in life insurance 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. [www.advancedsettlements.com](http://www.advancedsettlements.com) 1-800-561-4148

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## Helpful Links

**American Association of Fundraising Counsel and AAFRC Trust for Philanthropy**  
<http://www.aafrc.org/>

**America's Charities**  
<http://www.charities.org/>

**Association of Fundraising Professionals**  
<http://www.afpnet.org/>

**Charity Channel**  
<http://www.charitychannel.com>

**Charity Navigator**  
<http://www.charitynavigator.org>

**The Chronicle of Philanthropy**  
<http://philanthropy.com/>

**Council on Foundations**  
<http://www.cof.org/>

**CreateHope.org**  
<http://www.createhope.org/>

**The Foundation Center**  
<http://www.foundationcenter.org/>

**Guidestar**  
<http://www.guidestar.com/>

GuideStar is a database that provides information on 501 (c) (3) nonprofits, including program descriptions, IRS 990s and 990PFs, newsletters, and press

**National Association of Insurance Commissioners**  
<http://www.naic.org>

**Network for Good**  
<http://www.networkforgood.org/>

**Nonprofit Times**  
<http://www.nptimes.com/>

**Online Fundraising Resources**  
<http://www.fund-online.com/classes/rollins/index.html>  
An online class in researching and funding presented by the Philanthropy Center.

**Viatical & Life Settlement Association of America**  
<http://www.viatical.org>

