

BANKING FEATURE



Bankers Need to Know about Life Settlements

[By M. Bryan Freeman]

Bankers – especially those working in trust and “workout” departments – would do well to learn about life settlements. Currently, only a handful of cutting-edge bankers in larger markets truly understand what life settlements can mean to them and to their clients. But a trend has started that will quickly proliferate throughout the banking community.

In short, a life settlement is the sale to a third party of an existing life insurance policy for more than its cash surrender value but less than its net death benefit. Such transactions are usually undertaken – based on the insured’s shortened life expectancy – for the purposes of estate or financial planning. The option also is available to some people who are terminally ill.

It is important for bankers to know about this concept because life insurance policies are often part of the mix bankers have to deal with, either as collateral, as part of a trust, or in some other scenario.

You see, a fundamental misunderstanding about life insurance – even among those who generally understand that industry – is that life policies can be upgraded. That’s right: life insurance itself has changed dramatically. The architecture of modern policies is very different from those offered 20 years ago and light years from policies offered 25 years ago.

That might not seem to be an important fact for bankers to know until they realize that an underperforming, outmoded policy is central to a trust they control. Or, in the case of a life policy offered as collateral that a bank takes over when a client defaults on a loan, the life settlement may be the best chance the bank

has to realize a sizeable amount of cash from the policy.

Settlements within Trusts

Let’s take a look at the life settlement/trust situation. We know that bankers love to have funded trusts containing real assets, such as stocks, bonds, and other real financial instruments. Irrevocable life insurance trusts (ILITs) are a stepchild to funded trusts, but they are a very common one. Hundreds of thousands of ILITs exist in the U.S.

Far too many ILITs contain under-performing life policies, those out-dated, old-architecture policies we talked about earlier. In the worst cases, these under-performing policies result in the trustee having to ask the grantor for more premiums.

But bankers in the know might look at these outmoded trust policies as a huge goldmine instead of a landmine. Using the concept of a life settlement, a trust officer could recommend and even foster the sale of the outmoded policy, replacing it with a new, more modern, and better performing life policy that would provide better financial performance and not necessitate the influx of additional monies from the grantor.

How would this work? Well, the old policy is

sold through a life settlement for a portion of its face value. The proceeds of the sale are then used to purchase a new policy that is better designed and boasts better performance.

Looking at this ILIT scenario from the standpoint of a trust officer’s fiduciary responsibility, you can see how an otherwise proficient trust officer could even be sued and held liable if not acting in the best interests of client and grantor. In this case, for not recommending a life settlement when such could create a “save.”

Settlements to the Rescue

Now, what about those circumstances in which a bank holds a life policy as collateral and the collateralized loan goes awry? That’s when we implement a Loan Rescue Program, which is exactly what it sounds like.

Let’s say a physician takes out a \$500,000 loan for a term of 35 months. When she still owes \$450,000 on the loan, she is diagnosed with Stage 4 liver cancer. The bank that made the loan spearheads a life settlement on the \$500,000 life policy the doctor used to secure the loan. By doing so, they collect \$250,000 in life settlement proceeds and only have to write down \$200,000 – quite a difference.

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So, you can see why workout departments are increasingly interested in life settlements, which hold the potential for salvaging a huge part of potential default loan losses.

Not that the trust and loan rescue scenarios aren't compelling enough, but why else might bankers need to know about life settlements?

For one, banks might consider buying life settlements or funding companies to buy them; larger banks in particular can do this. Some familiar banking names already involved in the life settlement industry include Deutsche Bank, RBS, Bank of New York, and Wells Fargo.

Bankers might also make loans against life settlement portfolios – that is, a group of life settlement policies held by a life settlement provider, a company that purchases policies for settlements. Some banks also act as escrow agents for life settlement transactions. And, finally, banks are sometimes called on to act as trustees of a trust within bankruptcy proceedings, and the said trust or other holdings might include life policies.

There are tax liability and other such issues to consider when speaking of life settlements, so bankers helping weigh the life settlement option for clients should be knowledgeable themselves and should likely consult with an accountant, financial advisor, or attorney knowledgeable about settlements.

Informed and Ahead

Many professionals – bankers included– have taken it as a given that new models of automobiles and other technology emerge on a regular basis. But many do not know that there are also newer “models” of life insurance policies being developed all the time. This is the phenomenon that enables savvy consumers and their bankers to trade to better-performing policies through a life settlement.

Only cutting-edge insurance agents truly know how to make the most of life settlements; very few bankers do. Even so, life settlements in banking scenarios are coming on fast. Be ahead of the curve and learn about these settlements before you have to. Your clients and your board of directors will thank you for it.

About the Author

M. Bryan Freeman, a licensed insurance agent for 28 years, is founder and president of Habersham Funding LLC, an Atlanta-based life settlement provider that does business nationally. He has helped people sell their life insurance for 18 years and completed four terms as president of the Life Insurance Settlement Association. Freeman is also a founding director of Private Bank of Buckhead, a community bank in Atlanta and is the founder of Life Settlement University, which helps professionals master life settlements. He can be reached at 888-874-2402 or bfreeman@habershamfunding.com.

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