Selling a cash-value life insurance policy? Better be careful

by Lynn O'Shaughnessy

If you own a cash-value life insurance policy, you could have insurance agents pestering you to sell it. Behind the scenes, there are some powerful -- and sleazy -- reasons why some policyholders are being urged to swap their policies for cash.

Many people aren't aware that they can sell their policies, but the fast-growing life settlement industry is determined to talk as many customers as it can into relinquishing their policies. Life settlement companies buy life insurance from policy owners, take over the premium payments, then collect the death benefit when the insured person dies.

The companies entice the curious with a simple message: If you no longer need the life insurance or you can't afford the policy, we can buy it from you for more than its cash surrender value -- that is, what your insurance company would give you if you decided to cancel your policy. For many people, this offer sounds a lot better than the deals that send contestants into fits of giddiness on the "Price Is Right." But is it?

Before you can possibly answer that question -- which is vastly more complicated than it looks -- you have to know whether an outsider would even covet your policy. A firm will take a pass if it suspects that you share Methuselah's DNA.

Buyers will be more excited if your doctors predict you'll live for no more than seven to 10 years, but you still could generate some interest if your life expectancy doesn't exceed 15 years. The shorter your life expectancy, the more money you should get. The life settlement firms will expect documentation of your health from your physicians, which can cost hundreds of dollars.

Because of the costs involved in these transactions, nobody is going to get excited about a policy that has a death benefit that's worth less than $100,000. Many policies generate a purchase price of 15 percent to 30 percent of the face amount. That, however, doesn't include the brokerage commission, which can be huge.

Glenn Daily, a fee-only insurance consultant, suggests that the way in which insurance agents and life settlement brokers are rewarded for generating new business is "bizarre." Commissions, which are often 6 percent, aren't calculated on the policy's purchase price but on its face amount. So if the policy's face value is $1 million and the purchase price is $150,000, a 6 percent commission would be $60,000, not $9,000.

You don't need an economics degree to appreciate why an agent might not always be motivated to find the largest purchase price for his client when he's going to get paid the same amount no matter what offer he reels in.

This strange compensation arrangement could be one reason why the industry is in the cross hairs of Eliot Spitzer, the New York attorney general who won election as his state's governor Tuesday.

Last month, Spitzer filed a lawsuit against Coventry First LLC in Philadelphia that alleges the industry leader rewarded life settlement brokers with secret payments to send business their way. The brokers are supposed to obtain the best prices for their clients by seeking bids from various life settlement firms. But Coventry First allegedly paid these guys under the table so they would tear up other offers.

According to Spitzer, the investigation, which industry observers expect to broaden, has uncovered more than 200 Coventry First cases nationwide where brokers pocketed undisclosed commissions of 50 percent or more of what the elderly sellers received. If true, that's stunning.

"People in the life settlement industry like to think that they are providing a wonderful new service that bridges the gap between the insurance industry and capital markets," Spitzer said in his lawsuit announcement. "But the reality is that too many industry players are cheating policy owners to maximize profits for themselves and their firms."

In one case, Coventry First allegedly offered $705,000 to an 80-year woman who possessed a $4.9 million insurance policy. But according to internal e-mails, the woman's broker had a competing offer worth more than $1 million. After Coventry allegedly gave the broker a $49,000 secret payment, the competing offer disappeared. Maybe the broker accidentally dropped it in the paper shredder.

In a statement, Coventry First Chief Executive Alan Buerger complained that prosecutors are making his company a scapegoat for perceived problems in the industry and suggested that the case was built almost exclusively on "out-of-context e-mails that do not support the allegations."

Even if we could assume that all these transactions are squeaky clean, Daily, the insurance consultant, believes that life settlements are only appropriate for a fraction of policyholders. "Most people would keep their policies if they understood the economics," he said.

Because of the mind-numbing complexity of evaluating policies, it makes sense to book an appointment with a fee-only insurance consultant if you are tempted to make any changes to a cash-value policy. These experts don't sell insurance and don't accept commissions or payment from insurers. Unlike insurance agents, they have no financial stake in whether a person buys, sells or surrenders a policy.

If you want to explore whether a life settlement makes sense, I suggest using Daily's service, which you can learn more about at www.WhatsMyPolicyWorth.com. The analysis includes an estimate of a policy's market value, an estimate of the value of the policy to your heirs if you keep it, and a comparison of the death benefit with the projected value of other investments. The analysis isn't cheap -- it costs $1,895 -- but it typically takes many hours to evaluate a policy and the alternatives. The price drops by $300 if your financial adviser orders the analysis and presents the findings to you.

When you consider that these policy sales can be worth hundreds of thousands of dollars, you'd be foolish just to proceed on a hunch.

Copley News Service