

ARTICLE

Estate Planning

Teaser:

As the many uses for a life settlement continue to be discovered, its value as a planned giving tool is growing.

Content:

Life Settlements As a New Planned Giving Tool

By Vicki Wilson

Life settlements are a relatively new financial planning tool, but the product today is recognized as a viable vehicle for creating liquidity from an unwanted or unneeded life insurance policy owned by people aged 65 or older. At the same time, many uses for the product are still being discovered. One area of growing interest is its potential value as a planned giving tool.

Today, life insurance is a heavily promoted source for planned giving by charitable fundraising organizations. This is due to the substantial value of these policies and the fact that many older contributors who no longer have a need for a policy purchased years earlier would be potentially interested to make a charitable contribution of their policy.

There are currently two main methods of soliciting contributions of a life insurance policy. Each existing method has serious limitations for the charity, which in turn limits the desirability of the donation, particularly from a short term perspective.

The first method of solicitation is a simple request that the policy owner amend the beneficiary designation to provide the charitable organization all or part of the death benefit of the policy. While the owner can change this designation, the addition of the charity as a beneficiary of the policy does not provide a current tax benefit to the owner. There may also be estate tax advantages following the death of the insured. The charity, meanwhile, knows it will only receive the proceeds following the death of the insured.

The second method of solicitation involves the assignment of the policy by the owner to the charity. This method involves the transfer of the title to the charity, and therefore generates a charitable contribution at the time of the assignment. The value of the donation depends on the type of policy donated, but generally the donor can deduct the surrender value as well as any ongoing premium payments made. The charity's ability to convert this to immediate cash depends on the amount of the policy's cash value, if any. It will only receive the death benefit if the donor or the charity continues to pay the policy's premiums.

With the life settlement, a new vehicle exists for creating value from life insurance policies. A life settlement entails the transfer of the title of a life insurance policy to a third party life settlement company. The life settlement company pays cash for the right to obtain title to the policy, usually from a person over age 65 with life expectancies ranging between two and twelve years. The company then assumes responsibility to pay the ongoing premiums to the insurance company that issued the policy, and eventually collects the death benefit. Most life settlement companies are backed with institutional financing, which means that the individual policies are not being resold to investors.

A life settlement company always pays more than the cash value of the policy.

Therefore, through a life settlement transaction the donor will be able to capture a greater value for his or her tax deduction. Another benefit for the donor is that the life settlement provider becomes responsible for ongoing premium payments, thus eliminating this burden from the donor. For the charity, the donation through a life settlement delivers an immediate liquid benefit.

Over the range of policies assigned for life settlement, the charity could receive a payment of approximately 20 percent of the face value of the policies donated or over 3.5 times the cash surrender value of the policies. This will be achieved without the need for continuing the premium payments by the charity and without the need to wait for the demise of the donor.

Life settlements can be a valuable planned giving tool if the charity is interested in using this vehicle to convert a donated policy into immediate income. If so, the donor will need to provide sufficient information to the life settlement company to enable it to make a determination if it will make an offer for the policy and for how much.

As with any significant financial transaction, a life settlement should be examined and executed under the guidance of a trusted advisor of the charity, the donor, and their tax advisors to determine the tax and financial impact of such a transaction.

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