

Unneeded life insurance policies become brand new market for investors

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Broker Daniel Katz matches unneeded life insurance policies with buyers.

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Someone in the world is willing to make book on when you'll die, and they are even willing to share some of the profits with you beforehand.

A new investment strategy is emerging from the bleak world of viaticals, only this time with a happier face. Viaticals involve the purchase of life insurance policies from people with terminal illness, typically AIDS or cancer, when the life expectancy is measured in months.

"You're dealing with people who need cash for their immediate needs; it's a grim kind of work," says Daniel Katz. "That's transformed so now you don't have to be terminally ill to sell your life insurance policy."

Katz is president of Memphis-based Settlements for Life, a 4-year-old pioneer of the concept. As a broker, he's in the business of matching unneeded insurance policies with buyers. The buyer offers cash up front and assumes the premium payments. When the covered person dies, the buyer is the beneficiary.

To be worth selling, the policy must have some cash value, so the most popular are whole life and universal life policies.

"For multiple reasons people buy life insurance, to protect the family or sometimes save on estate taxes," says attorney Steve McDaniel of Williams, McDaniel, Wolfe & Womack. "But the world changes: kids grow up, tax laws change and clients realize that they are paying for insurance they do not need."

McDaniel's entire practice is in estate planning and probate. The automatic reaction in such cases, he says, is to withdraw the cash value and let the policy lapse. But now it's possible to get more than the cash value if someone buys it.

The concept is so new that he's only had two clients sell a policy. The initial reaction is usually disgust.

"Once you get over the creepy aspect of selling your policy to someone you don't know, you start to think about it," he says. "Why lapse it for \$10 if you can sell it for \$12? It's a business decision."

One client in poor health was paying \$750 a month on a \$100,000 policy. Rather than take the \$10,000 in cash value, the policy was sold for \$45,000.

Unlike term insurance, whole life and universal life are influenced by interest rates, so over time the policy can be a financial annoyance to those with plenty of money.

Settlements are usually marketed to those with a comfortable estate and no financial worries. Their assets are protected and their children are successful of their own accord. In these cases, the settlement can mean a windfall to be spent on something fun. Or it can fully fund a term policy that will provide a windfall later for the survivors.

But for one of McDaniel's clients the settlement was much more significant.

"The premiums had become very difficult, and we were able to sell the policy for a substantial amount, several times the cash value," he says.

150 years ago it was popular in England to buy life insurance on strangers who often died mysteriously soon after the policy was issued. That led to modern laws that say a policy can only be taken out when there is a vested interest, such as a family member. Companies can buy life insurance on key executives.

The market that buys life insurance policies today does not identify individual people, Katz says. A mutual fund may seek \$10 billion in face value of policies, vacuuming up policies from brokers like Katz. The policies are bundled like mortgages and function as any other financial product on secondary markets.

Settlements operate on the same mathematical formulas that are behind insurance actuaries, balancing life expectancy against the premiums and the future payoff. Buyers have no animosity against the insured, but are only calculating a return on investment that hinges on death.

To be valuable to an investor, the policy must cover someone with a health impairment. If they are also older than 70, it adds greater value.

"The policy and value are based on health," Katz says. "The buyer has to estimate the cost of money over time."