Cashing Out

10 Tips for Optimizing Your Life

By Rhona Sacks, JD, MBA, CLU

Upon deciding to sell your company and retire, your primary goal is to extract maximum value from the business you've worked hard to build. Unfortunately, too many exiting entrepreneurs (as well as their legal, financial and business advisors) leave too much cash behind because they fail to recognize the enormous value hidden within one of their most overlooked and underutilized business assets.

Companies purchase life insurance policies for risk management, employee benefit and investment purposes. When a company is up for sale, some of these life contracts may become obsolete because the reasons for their purchase are no longer relevant. And after a company is sold, additional business life policies may outlive their usefulness.

Historically, exiting entrepreneurs faced limited disposition options when their changing needs rendered their business life policies unnecessary: allowing the policy to lapse, thereby forfeiting the value of all premiums paid or surrendering the policy to the original insurer for its cash surrender value, an amount which doesn't reflect its true value.

An innovative asset optimization technique, a life settlement (the sale of a life insurance policy to an institutional investor for a cash payment that is greater than the policy's cash surrender value), can convert the hidden value in no longer needed qualified business life insurance contracts into significant immediate cash. This windfall can be used for any purpose, including facilitating the sale of your company for the desired price and on favorable terms.

When you consider that the average cash surrender value of a life insurance policy is only 4% of the face value[1] while the average life settlement payout is 16%[2], a life settlement can be an effective tool for liberating substantial liquidity hidden within a dormant business asset.

Although selling your no longer needed business life policies in the secondary life insurance market can be profitable, navigating the labyrinthine life settlement marketplace can be challenging. The nascent life settlement industry, in general, lacks ample due diligence and transparency as well as knowledge of and services responsive to the unique needs of retiring entrepreneurs in the process of selling their companies.

These 10 tips will help you to efficiently optimize your life:

1. Be basic.

Although life settlement viability is determined on a case-by-case basis, you and your expendable business life insurance policies need to satisfy basic requirements:

- The insured is 65 or older.
- The policy's death benefit is $250,000 or more.
- The policy has been in force for at least 2 years.

2. Be specialized.

Analyzing the expendability of your business life policies, coordinating the sale of your obsolete policies with the sale of your company, safeguarding your privacy and securing the highest quality institutional offer demand specialized advisory skills in exit planning, business life insurance and life settlements. Working with an independent advisor who has expertise in these disciplines is the key to a successful, efficient transaction.

3. Be independent.

In search of the highest quality institutional offer, an independent advisor will secure trustworthy and superior brokers (which field qualified life policies to multiple providers) and providers (which purchase qualified life policies on behalf of institutional investors) by exploiting every viable life settlement industry resource on your behalf, thereby leveraging all of the exclusive relationships and intellectual assets that a particular broker or provider may have. Having uncompromised access to an ever-changing marketplace of brokers and providers uniquely offers you exceptional flexibility to sell policies of every type and face amount across a full range of life expectancies, which facilitates an efficient process for obtaining a maximum payout from a high-quality provider.

Furthermore, if you solicit a bid directly from a provider, you may (unknowingly) receive a low-ball offer that an industry-savvy advisor would know doesn't represent true fair market value. Because a provider's allegiance is to its institutional investors, the company is obligated to purchase policies at the lowest possible price. Therefore, working directly with a provider or with only one provider may be inconsistent with receiving the highest quality offer, which demands a competitive market of different providers.

4. Be due diligent.

It's important to recognize that although the price offered for your unneeded business life policy is a primary competitive factor, it isn't the only factor. There are other, equally important, aspects of the life settlement transaction that also need to be carefully considered. You may be surprised to learn that the highest offer may actually not be best because it is a poor-quality offer that will not ultimately benefit you.

Fully understanding the source behind each offer is critical to protecting your private information as well as your life settlement transaction. To preserve your confidentiality, a provider that takes any kind of procedural shortcut to maintain competitive pricing should always be avoided. In addition, only offers from providers that place your settlement funds in an independent institutional escrow account should be considered because this ensures that your money will be available before your policy is transferred.

To safeguard your privacy and the integrity of the life settlement process, your independent advisor needs to conduct continuing due diligence when selecting brokers and providers with whom to work. This exploratory process assures that your confidential information is available only to qualified, reputable brokers and providers who are committed to protecting your privacy.

In addition, it's essential not to associate with brokers or providers who would use private money (from individuals rather than institutional investors) to purchase your policy. This ensures that your policy becomes a part of a large portfolio of polices owned by a credible financial company, rather than a single policy owned by an unscrupulous individual. Only institutional capital offers maximum protection from privacy and fraud risks, and it's the only kind of funding you want used to buy your business life contract.

5. Be transparent.

Your trusted advisor acts as a fiduciary on your behalf, which is the highest legal duty to act in good faith. This is a legal and moral obligation to always put your interests first. To fulfill this duty, there should never be any hidden conflicts of interest in his or her compensation. And, your advisor should never accept any fees from any source to recommend the sale of your policy for less than the best offer from the best company—a high-quality provider who offers true fair market value as well as safeguards privacy.

Full disclosure as to broker compensation is also necessary to ensure that there are no provider side deals involving suppressing bids in exchange for payments of any kind, including, holdbacks, bonuses, overrides, incentives and/or other fees over and above commissions. Only a broker that employs an open architecture bidding platform wherein all provider offers and counteroffers are documented, thereby ensuring a transparent purchasing process, should be permitted to market your life policy to providers.

6. Be helpful.

Although each case is unique, the average life settlement processing time is 2-4 months, with delays frequently being caused by doctors and insurance companies who are slow to respond to third-party requests for your medical and policy information. Although an advisor can retrieve these documents for you (after receiving your signed authorizations to do so), simply calling your insurance carrier and requesting your life policy's "In-Force Ledger" as well as asking your physicians to release your "Attending Physician Statements" can significantly speed up the processing time—even cutting it in half.

7. Be singular.

Having more than one broker shop your policy may yield a lower price because it creates a confused marketplace wherein providers labor to effectively negotiate with multiple brokers at once. Reputable providers prefer working with one credible broker because it is a more efficient policy purchasing process.

Moreover, the auction-like market created by a singular brokerage provokes spirited competition amongst providers, which motivates a provider to tender a best first bid. In contrast, when several brokers offer the same policy for sale to the same provider, this potential purchaser has less impetus to proffer its best price in anticipation of possibly buying the policy for less at a later date from yet another broker. This inefficient strategy hinders the life settlement process because the provider, who should be competing with other providers, begins competing with brokers, which only serves to drive down prices.

8. Be timely.

Ask your advisor to inform you, in writing, of every provider offer as well as its expiration date, which is usually 14 days. This time limit for accepting a bid is a good reason to stay in close contact with your advisor during the entire bidding process. You don't want to miss a deadline for an excellent offer from a high-quality provider because you may not get a better offer.

9. Be tax-aware.

The proceeds from selling your superfluous business life policies may be subject to taxes, and it's important to seek guidance from a knowledgeable tax professional. Although there are no Internal Revenue Code amendments specifically relating to the taxation of life settlements, there are several relevant general guidelines that have been used in past transactions:

- No tax is due on the amount equal to a policyholder's basis (total premium expenditures) because it is considered a return of capital.
- Ordinary income tax is due on the difference between the total premiums paid and the cash surrender value. By the way, if the policy was tendered back to the originating insurance company for its cash surrender value (rather than sold for more in the secondary life insurance market), the policyholder would owe exactly the same amount.
- Long-term capital gains tax (15% maximum tax rate) is due on any amount received in excess of the cash surrender value. A life settled business policy qualifies as a capital asset because it has been owned in excess of a year.

10. Be happy.

After the sale of your obsolete business life policies has been successfully coordinated with the sale of your business, celebrate how well you have optimized your life, and enjoy your retirement. You deserve it!

Rhona Sacks is the founder and president of Legal Life Settlements, a mergers and acquisitions advisory company specializing in helping retiring business owners extract maximum value from their hidden business assets. Legal Life Settlements is the only firm in the life settlement industry exclusively dedicated to serving the unique needs of exiting entrepreneurs. For more information or to receive a copy of the article, "Cashing Out: Your Hidden Business Assets," please call (650) 477-2726 or visit www.legallifesettlements.com.

Endnotes

1. *"Turn Unneeded Policies Into Cash: A Life Settlement Can Be A Better Alternative Than Surrendering A Policy,"* Journal of Accountancy, September 2005, James D. Warring
2. Advanced Settlements, 2008