



Case Study | The Potter Family

FINANCED LIFE INSURANCE – TWO YEARS LATER: ANALYZING THE OPTIONS ONCE THE FIRST TWO YEARS ARE UP

BACKGROUND:

In 2005 Mr. Potter (a client referred to us by his attorney) entered into an arrangement whereby he agreed to put life insurance in force utilizing funds provided by an outside source. Should Mr. Potter elect not to pay the loan back, the funding source could control the policy after two years. As an inducement to enter into the arrangement, the client received a payment up front. Several options were to become available after two years.

The advisor contacted us in 2007 because the initial two-year period was about to expire, and it was now time to analyze those options and decide on a course of action. He understood there were variables he could not define, and complex issues that had to be identified and reviewed:

- The client's need or desire to retain the coverage
- The costs to retain the coverage
- The efficiency of the existing coverage compared to new coverage
- The client's ability to obtain new coverage
- Financing alternatives
- The client's current health

One option, should he pay the loan back and control the policy, would be to enter the policy into a life settlement transaction. In order to provide the client with information that would be helpful with his decision, we needed to calculate a breakeven year. Based on an estimated settlement value, the client's life expectancy, his projected portfolio rate of return and the cost to retain the coverage, we could provide Mr. Potter and his advisors with this critical piece of information.



THE SITUATION:

This case exemplifies how one advisor understood the alternative options available to his client. This typical “non-recourse” life insurance transaction included variables such as need, ability to replace, current health status, cash flow, the client’s or family’s desire to retain the coverage as an investment alternative and the quantitative analysis of a settlement.

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Mr. Potter was now 80 years old. He purchased \$10.0 million of life insurance for an annual premium of \$450,000. He received \$250,000 as an up front inducement to enter into a non-recourse financing transaction that allowed the investor to keep the policy after the first two years.

Mr. Potter had three alternatives:

1. Relinquish the policy to the funder.
2. Retain the contract as an additional asset to be passed to his children. He would need to repay total indebtedness of \$1,564,203:
 - \$900,000 advanced for premiums
 - \$339,203 of accrued interest at LIBOR plus 500 basis points
 - \$75,000 in legal and structuring fees
 - \$250,000 paid to Mr. Potter at initiation of the transaction
3. Retain the contract, repaying the outstanding indebtedness, in order to then sell the death benefit in the life settlement market.

Mr. Potters’ current health, overall estate and financial plan, projected estate tax liability, liquidity and asset allocation all play a role in the determination. Also included was the annual cost to maintain the policy, the integrity of the insurance illustration, the financial stability and claim’s paying ability of the insurance company, and the policy’s value in the life settlement marketplace.

THE SOLUTION:

Mr. Potter was in good health. An analysis was completed of the rate of return represented by the death benefit (in future years when compared to the initial \$1,564,203) and required ongoing annual premiums. Next a life settlement inquiry was initiated to determine the value of the policy in the life settlement marketplace. An informal inquiry was completed to ascertain the cost to replace the coverage (should it be sold) utilizing the additional proceeds from a projected settlement to reduce future premiums on new coverage.

Mr. Potter decided to retain the contract for purposes of life settlement. The proceeds of the settlement repaid the \$1,564,203 advanced to the funder, with the balance used as an additional first year deposit on a new \$10.0 million policy. It was placed in a new trust at a premium lower than required on the original policy. Mr. Potter was well served, and his advisor was satisfied his client made the correct decision once they had the facts.

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