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## SETTLEMENTS OF 'KEYMAN' POLICIES MAY INCREASE

### Economy Motivates Sellers

by Dennis Pfaff

It's not uncommon for companies to protect themselves against the loss of one of their most critical components – their high-ranking executives who possess the knowledge, institutional memory or talent for innovation that made the firm successful.

But, particularly as times get tougher and those executives inevitably get older, some companies are deciding that the insurance they bought as a hedge against a future calamity might have value in the here and now.

Settlements of such "keyman" policies have been going on for some time, especially among privately held companies, according to market players. But more recently, even public companies have joined the club. At the same time, the policies are beginning to be viewed in some cases as assets with value in bankruptcies.

The transactions are not without controversy or critics, who raise red flags over the tax implications or other potential consequences of the settlements. But for some companies settling such policies can be an ideal route to take, supporters argue.

"As this industry has gained traction we are starting to see good estate planning attorneys and good corporate attorneys now understand that they have an asset that's on their books that they can obtain value for," said Robert Finfer, chief executive of life settlement broker **Integrity Capital Partners** in Bethesda, Md.

Integrity recently facilitated the settlement of second-to-die policies for the founders of Grand Rapids, Mich.-based X-Rite Inc., which makes technology used to analyze and match color. The sale of four policies generated more than \$20 million for X-Rite, the company said.

*"Our marketplace is all about sifting through the maybes to get to the definites."*

*—Douglas Himmel  
Melville Capital*

Finfer said the X-Rite transaction was the first his firm had handled for a public company although he had been involved in many others by private companies. Finfer said he had been putting keyman policies into the secondary market as early as 2002. Corporate filings by X-Rite show that it previously sold some policies as early as 2005. Integrity also handled those transactions, Finfer said.

Finfer said he sees the settlements of such policies as a growth segment.

"I think that side of the marketplace, which has been essentially untapped, is now in the market," he said. "They're looking at this as an opportunity, where they weren't before, to raise capital."

Particularly with the economic downturn, executives are "digging deeper" to find assets on their books, Finfer said. At the same time, he noted

the increased public attention being given to such transactions and that they are becoming more mainstream.

Dealing with public companies poses some challenges that are different from those with other sellers, however. Those include a higher degree of transparency and scrutiny.

Market players describe the mechanics of transactions involving corporate-owned policies as virtually identical to those held by individuals. But there are differences in tone.

"It's a little bit, in some cases, easier to work with a corporation because they are bottom-line guys," Finfer said. "There's less emotional distress in the situation."

"The good part of it for us is it's a business decision, it's not an emotional decision," agreed Douglas Himmel, a Los Angeles-based managing director with brokerage **Melville Capital**. Himmel said his firm is actively "educating the corporate adviser market" on how to spot such assets.

He, too, called settlements of such policies an "untapped market," but he noted that they are not always as straightforward as dealing with "Mr. and Mrs. Smith down the street." That's because there may be agreements between the company and the executive that, for example, provide for a split of the proceeds.

Others may involve employees who are beyond the age where the policies can be converted from term

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to more marketable universal coverage. A disproportionate number of the corporate-owned policies are term policies, Himmel said. But he said the vast majority could be converted to permanent policies. He said that's done only after a bid on a policy is accepted and the money is in escrow, reducing the risks faced by the selling company.

"Our marketplace is all about sifting through the maybes to get to the definites," he said.

Keyman policies have long been an important part of the life settlement market, said Larry Simon, president of provider **Life Settlement Solutions** in San Diego. But he described the market as undergoing changes due to the current stresses in the economy.

"What we're seeing now, both on the keyman and the other side, is that people are now selling policies because they have to," he said. "Because of the market, because of the economic conditions, people that would otherwise not be selling those policies may be doing so as a source of cash."

But some see a downside, noting that sellers may be exposing themselves to income tax liabilities that would not be imposed on death benefits.

"The problem is, in a capital gains, the company is paying normal income tax, at least at a company level," said Matthew Schiff, president of Schiff Benefits Group, an executive benefits consulting company in Blue Bell, Pa. "It doesn't make a lot of sense."

Another problem with settling such policies, he said, is that a life expectancy estimate still has to be produced, even though the employee might no longer be with the company.

Most of the companies he has encountered want to hold onto keyman

policies because they will someday produce a big windfall, Schiff said.

"But with companies running into cash crunches, it's a possible quick way of finding some cash," he said.

Others might choose to sell because the current economy has left them less able to pay premiums, Simon said.

X-Rite, for example, saved \$6.7 million in annual premiums on the policies it sold, which had a face value of \$130 million. Finfer said at the time that the settlement achieved a valuation in excess of 50% over the cash surrender value for the policies.

As for the issue of life expectancies, Simon said that while they could be an issue in some cases, the documents have already been prepared by the time a policy comes to his company.

"They really can't submit to us without having the life expectancy report," he said.

In a sale of a corporate-owned policy "you need the cooperation of the insured," said Finfer. The individual must, for instance, authorize the release of medical records.

In some cases, Finfer said both the corporation and the individual might share in the proceeds of the settlement. He said it's also not uncommon for the person to have been offered the opportunity to take over the policy when he or she leaves the company.

Bankruptcy court is another venue where keyman policies may be getting more attention. In 2007, a federal bankruptcy judge in Woodland Hills, Calif., overseeing the Chapter 7 liquidation of Ronco Corp. and Ronco Marketing Corp., authorized the sale of a \$15 million, 10-year term policy on the late-night television face of the company, Ron Popeil. Popeil, known for TV commercials hawking products such as the Pocket Fisherman and the Veg-O-Matic, had sold his interest in Ronco in 2005, according to published reports.

It was not known exactly how much the policy fetched, although Himmel, whose company was authorized by the bankruptcy court to handle the deal, said the "gross offer was north of \$3 million."

The transaction could help promote the idea of breaking out policies as discreet assets in such cases. It certainly caught the attention of Daniel Reiss, of the Los Angeles law firm **Levene, Neale, Bender, Rankin & Brill**, who represented the bankruptcy estate's trustee in the case. The veteran bankruptcy attorney said the Ronco case represented a first for him.

"I'm sensitized that those [policies] may or may not be worth money on the secondary market," Reiss said.

Gregg M. Ficks, a San Francisco attorney who leads the bankruptcy practice at **Coblentz, Patch, Duffy & Bass**, said he had not seen such assets sold separately in past cases. But he sees the possibility of such sales becoming more common as the credit crunch makes it more difficult for companies to reorganize under bankruptcy protection. That means that more companies may liquidate, rather than reorganize, in bankruptcy. Ficks said that policies might be sold as part of the entire estate but that a "savvy trustee" may now want to sell them separately.

"These are assets that should be peddled," Ficks said. "There's no reason the creditors shouldn't get the benefit of this and now that there's more visibility around this issue I think you probably are going to see more of it."

Himmel said, however, that the sale of keyman policies in bankruptcy poses challenges with court procedures and the involvement of attorneys "on every side of the equation."

"It's considerably longer-winded," he said. "It's tremendously more expensive."

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