

## A Meaningful Recovery at a Perfect Time

# Life Settlements of Corporate Owned Life Insurance Policies

In today's turbulent economic climate, companies and their advisors must maximize the value of all corporate assets, whether because of succession planning, the sale of a company, reorganization, or liquidation. More than ever, diligence and creativity play a larger role in maintaining a company's health and viability.

Key person (and other corporate owned) life insurance policies have long been an integral part of corporate America. They are usually viewed as a contingent asset since the policy has no value unless the key person dies. In a typical scenario, the company pays the premiums and is designated as the owner and beneficiary of the policy. It can be a very effective way to offset any financial impact associated with the sudden loss of the key executive, but the policy often has little or no value to a company that is going through a sale, cash crunch, reorganization, or liquidation. Moreover, due to the ongoing premium obligation, these policies are often viewed as a liability instead of an asset. The same is often true with other types of life insurance policies, including policies that have been used to fund buy-sell agreements, split-dollar policies, and personally owned policies that the company has assigned to its lenders.

### The Mechanics of a Life Settlement

Until somewhat recently, there were only three options the policy owner, whether it's the company itself or a court appointed trustee:

1. Allow the policy to lapse, thereby discontinuing future premium payments.
2. Continue paying the premiums and keep the policy in place.
3. Surrender the policy to the issuing insurance company for the cash-surrender value.

A life settlement may be the perfect solution for a company whose needs or financial condition has changed. A life settlement is the sale of an existing life insurance policy to institutional investors from the current owner or assignee (the company, if it is a key person policy). The buyers are institutional investors, which are typically, although not exclusively, commercial; investment banks; pension and hedge funds; and insurance companies. These investors underwrite the policies' fair market value and purchase them from the policy owner for a one-time lump-sum payment. Upon the settlement, the purchaser assumes title and responsibility for all future premium payments.

Most varieties of life insurance are eligible for this option including universal life, variable universal life, and convertible term policies. Also, since many corporate-owned policies are term

in structure, they may prove to be the most hidden and valuable asset. These policies are rarely disclosed on schedules or statements of financial condition and they are frequently overlooked when the due diligence is being done.

Since they do not accrue any cash-surrender value, they are often cancelled, ignored, or otherwise permitted to lapse for non-payment at the first sign that a company is changing hands or is in trouble. Since most term policies have a conversion feature, providing the owner with the right to convert to a permanent policy may be a very useful way to extract value from an asset that had been considered worthless. The life agent who is advising the company would look great in this scenario because they looked at outside-the-box solutions to solve their client's issues. Also, the agent may be writing a sizable term conversion and could possibly participate in the compensation from the life settlement transaction.

To qualify for a life settlement, the general rule of thumb is that the insured must be over 65 and have at least \$500,000 of life insurance coverage. In addition, several factors influence the policy's purchase price including age, gender, health of the insured, size of the policy, insur-

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ance carrier, and type of policy.

The process of selling a policy is relatively simple. It's strictly paperwork. There are no doctor visits or blood tests, which are required on a new policy issue. An application is signed; medical information is collected; life expectancy reports and policy information are gathered; and then a comprehensive package of information is sent out to the market. At that point, a life settlement broker

conducts an auction-like process in which bids are presented to the broker for acceptance. The broker should handle this process on a contingent basis.

## Legal Justifications for Selling a Policy

In 1899, New York's highest court held that policy owners have property rights with regards to their life insurance and, as such, they can go to the best market they can find to sell or borrow money on it (*Steinback v. Diepenbrock*).

In 1911, The U.S. Supreme Court laid some of the groundwork for today's life settlement marketplace when it established the policy owner's right to transfer an insurance policy (*Grigsby v. Russell*).

In the bankruptcy world, once a petition is filed, an estate is created pursuant to section 541, of title 11, United States Code, section 101 et seq. (the Bankruptcy Code). The bankruptcy estate is comprised of all legal or equitable interests of the debtor in property wherever located and by whomever held. As such, a life insurance policy that is owned by the bankrupt corporation upon the life of an owner, officer and/or large stockholder, at the expense of the corporation, passes to the trustee as an asset of the estate (*estate of Lellock v. Prudential Ins. Co. of Am*). Any money from the sale of the life insurance policy becomes the property of the company/debtor's bankruptcy estate (See generally, *In the Matter of Insulation & Acoustical Specialties, Inc.*). In addition, a debtor or trustee may use, sell, or lease property of the estate (other than in the ordinary course of business) upon notice to parties in interest and a hearing by the bankruptcy court.

Here are a couple of examples of bankruptcy cases in which life settlements were used to monetize insurance assets: The Illinois bankruptcy case called, "Wilder" was assigned to a Chapter 7 trustee. The estate had minimal assets, but had in excess of \$200 million in claims. Among the assets of the estate were three life insurance policies on the key man. Despite the trustee's efforts, they generated only a \$250,000

bid from a group of creditors. Since the trustee had never encountered life insurance policy assets in a case, she felt overwhelmed and conflicted about what was already a challenging case so she used a life settlement broker. Within a few weeks, the trustee filed to sell the three policies for \$8.9 million, which is 20 times greater than the previous bid she secured on her own.

A \$15 million term policy was on the verge of lapsing in the Ronco matter, which was in a California bankruptcy court, but it was converted into a universal life policy and thereafter marketed and sold. The proceeds of the sale were approximately \$3.3 million. The proceeds were delivered to the trustee and yielded enough to pay off the senior secured lender, in full.

## In Conclusion

Advisors to companies that are in transition at any point on the continuum (from very healthy to bankruptcy) have an opportunity and an obligation, in cases such as bankruptcy, to maximize the value of the assets/estates for the benefit of all parties involved.

In scenarios that include insurance assets, the policy should not be surrendered arbitrarily for the cash-surrender value, or worse, allowed to lapse without an appraisal of its fair market value. Advisors should consult with an experienced life settlement broker who has significant knowledge of the corporate space and specifically the restructuring and bankruptcy

world, in order to obtain the highest monetary value for these assets.

If a company is being sold, the sale of a policy may be what's needed to get the buyer and seller aligned on the overall price. With a troubled company, the potential for a successful reorganization always depends on the amount of available cash. Alternatives are needed when a debtor is unable to increase revenues or borrowing to bridge the gap. Often, an item that's not on the balance sheet, like the sale of a life insurance policy, can make the difference between staying in business and filing bankruptcy. A life settlement should be considered even in situations in which the policy has positive cash-surrender value since it may provide additional dollars and a significant cash infusion at exactly when it's needed. □

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