Insurance Insights

Equal vs. Equitable?

What does Equal vs. Equitable mean? Let's look at a hypothetical case involving life insurance that will help you become clearer.

Setting the Stage:

- A family which in this particular case will include the parents, their 3 children and several grandchildren. One of the families has 2 disabled children.
- The patriarch had a successful business he was winding down. His estate was about $4,500,000.
- His children were all financially independent but not wealthy.
- The disabled grandchildren were going to need on-going care for the balance of their lifetime.
- The patriarch wanted to treat each family equal but knew that he needed to provide a "little extra" to the child with the disabled children.
- The economic crisis was just beginning to impact the liquidity of many financial markets, time was critical
- The patriarch only had $1,500,000 of term life insurance
- He was 70 yrs. old with significant health issues
- The term had a level premium but was coming to the end of its guaranteed level premium and convertibility period

The dilemma; how to treat each unit equal but also equitable?

Does he let the policy lapse and not use any of the life insurance to solve his dilemma? Does he convert some or all of it? How will he help his one child out?

What to do? The cash flow required to convert all the term to permanent life insurance was cost prohibitive. The economic crisis was having an impact on the entire family. The term was only convertible through age 70. Time was of the essence!

Since all the term insurance couldn't be converted the simple answer would have been to convert a portion of the term insurance that would fit the budget of the patriarch. The conversion would have amounted to a death benefit of less than $300,000. The child who had the disabled children could not afford to allocate any of their resources towards the conversion. Was there any way to increase the permanent amount of life insurance above $300,000?

The Solution: In consideration of this particular fact pattern the patriarch could "sell" some of the term insurance in the secondary market and use those proceeds, plus allocate what was in his budget to convert a larger portion of the term insurance.

The Efficient Edge ◆ 120 S. LaSalle ◆ Suite 1710 ◆ Chicago IL ◆ 60603 ◆ P: 312.368.7560 ◆ peter.steger@efficientedge.net
Peter F. Steger CLU, ChFC, REBC – Principal, The Efficient Edge

The life settlement or secondary market still had some liquidity but it was tightening up due to the economic crisis. The policy needed to be converted in less than 90 days. How much should we convert if we do not know if a sale will go through? Since time was running down we had to react efficiently and quickly, normally these transactions take up to 6 months.

The first step was to get all the paperwork ready and to make sure the insurance company would be ready to convert the entire amount of term insurance using a no-lapse guaranteed death benefit product on the last possible day. The secondary market requires a definitive premium amount, a guaranteed death benefit feature and $0 cash value to make their best offer. His term insurance carrier had such a product. Not every insurance carrier offers no-lapse guaranteed death benefit products.

Based on our experience/knowledge of the secondary marketplace we know that in order to get the best offer we had to control the processing of the case. *How is this done?* Control the information flow to the insurance company to be able to negotiate from strength. As mentioned above, timing was critical. The entire $1,500,000 of term insurance had to be converted as close to the end of the convertibility period as possible. At the same time we needed to obtain offers from the secondary marketplace.

We had to act quickly in the sale of the policy as we felt the secondary market would "shut down" soon due to economic conditions in the U.S. Our resources were able to gather the necessary medical data to complete the Actuarial Longevity Analysis (ALA), a personalized life expectancy. This required masterful follow up as there were many physicians and clinics/hospitals that had to provide medical records before the report could be completed. We were able to obtain the ALA report in 3 weeks which is about half the time it normally takes.

The next step was to complete a Relative Value Report. The Relative Value Report is used to determine what we believe the offers should be from the secondary marketplace. This allows us to negotiate from strength and obtain the best offer. Many agents do not have the capability to approach the secondary market, and I do not of anyone that has our approach to the sale of a policy. The client will typically obtain an offer of 20% to 33% more from the secondary market by using our process of controlling the information, completing an ALA, and a Relative Value Report.

In this case we were able to secure an offer from the secondary marketplace and make the sale before the meltdown. We were able to time the conversion to minimize cash flow, stay within the patriarch's stated budget, therefore, maximizing death benefit coverage for the family. The family was able to keep close to $1,000,000. This is substantially more than what they initially thought would be about a $300,000 death benefit. We were able to complete this case within 120 days.

The patriarch was able to provide for his family both equally and equitably. He was able to split his estate equally among the children and at the same time provide a "little extra" for his disabled grandchildren without creating any internal family friction!

The Efficient Edge ◆ 120 S. LaSalle ◆ Suite 1710 ◆ Chicago IL ◆ 60603 ◆ P: 312.368.7560 ◆ peter.steger@efficientedge.net
Peter F. Steger CLU, ChFC, REBC – Principal, The Efficient Edge