

Life Settlements

Looking for a Calm Financial Harbor in a “Perfect Storm”



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Executive Summary

The U.S. is facing a three front crisis that poses long lasting implications for the providers of senior housing and senior care:

1. **The economy is currently in its worst slump since the great depression, and we may never see home values or commodity prices (fuel, groceries, etc.) return to where they were just a year ago.**
2. **The 65+ population is about to explode with the aging of the Baby Boomers, and as they age we will see life expectancies continue to increase.**
3. **Governmental budgets will be pushed more and more to the breaking point trying to fund the care of the exploding senior population through Social Security, Medicare, and in particular, Medicaid.**

The senior housing and senior care industry is only beginning to come to grips with this “perfect storm” of demographic and economic factors—and how it will impact the financing of their services. Adaptation and creativity will be necessary to stay ahead of the evolving U.S. socio-economic landscape.

In this paper we explore how a market innovation that emerged over the last decade called a “Life Settlement”, is now being used as an alternative funding mechanism for the entire continuum of senior housing and care.

Introduction: Stormy Seas Ahead

We see the headlines everyday.

Study Finds Increases in Nursing Home, Assisted Living Costs

Genworth study tracks fifth straight year of cost increases, trend to continue with Baby Boomers
–AP Newswire April 29, 2008

Americans Delay Retirement as Housing, Stocks Swoon

Nest Eggs Shrink; Deferring Dreams
–Wall Street Journal April 1, 2008

Bleak Retirements for 150 Million?

Majority of Americans aren't saving nearly enough; expenses they'll face are sobering
–MSN Money.com MarketWatch March 28, 2008

Housing prices to free fall in 2008 - Merrill

According to a Merrill Lynch report, home prices will drop 15 percent this year, and declines will continue in 2009 (and 2010).
–CNNMoney.com staff writer January 23, 2008

Only 1 in 4 U.S. Adults Think They Can Pay for Long-Term Care

74% Confident they do not have enough money, 33% Unsure
–SeniorJournal.com February 1, 2006

The economy is besieged by slumping home sales and foreclosures, erratic stock prices, imploding sub-prime mortgage portfolios, and people's incomes are being eaten up at an alarming rate by the increasing cost of goods and fuel. But for the most vulnerable of our population, seniors facing health and long term care challenges, the added pressures of this down economy have created a “perfect storm”.

The combined impact of these negative economic conditions, and the pressure on public programs to meet the increasing demand to fund senior care, is creating a surging tide for seniors that threaten to put many underwater. The undeniable goal of government is for individuals to cover senior housing and long term care expenses with more and more private funds. But very few have managed to accumulate enough savings to independently sustain years of quality lifestyle and care. Now, compounding this problem is the fact that traditional sources of funds are drying up as the housing and stock markets swoon.

According to a MSN Money.com Market Watch report (March 28, 2008) “a sixty five year old couple retiring now would need more than \$300,000 set aside just to pay for health care costs over twenty years and would need \$550,000 if they were to live into their early nineties.” Particularly alarming, according to the report, is the fact that these numbers, “haven't factored in the costs of nursing homes, assisted living facilities or home health aides—and those costs are staggering!” The reality is that very few people will have half a million dollars to cover health care costs-- without even accounting for the costs associated with long term care and retirement living.

Most people will depend on public funds to take care of them, but as the Baby Boom generation swells the number of seniors age 65 and over, those public funds will become harder and harder to access. Many others that are relying on equity built up in their homes or stocks are finding out now just how risky that proposition can be.

Fortunately, a financial tool has emerged that can provide a readily available source of funds for seniors that own a life insurance policy. It is called a Life Settlement, and very quickly it is becoming a financial tool for retirement living and skilled nursing facilities. In the face of falling home and stock values, rising inflation, and depleted savings; generating cash through a Life Settlement is rapidly becoming a welcome and much needed financial alternative to these strained resources.

A New Financial Option Emerges

The definition of a Life Settlement is simply this: It’s the sale of a life insurance policy by the policy holder while still alive to an institutional investor that will pay a lot more for the policy than the cash “surrender” value. The institutional investor will then carry the policy as an investment for the remaining life span of the policy owner. The Life Settlement secondary market emerged about ten years ago as financial institutions began competing to buy and hold people’s life insurance policies as investments. Life insurance values are guaranteed and disconnected from the economy so there is no fluctuation, as is the case with real estate and stocks. Understanding the significance of owning a life insurance contract with guaranteed value, all of the major players

on Wall Street (Morgan, Chase, Goldman, UBS, Deutsch Bank, AIG, etc.), as well as major hedge funds and global financial institutions are now buying people’s policies on a mass scale.

A Life Settlement can be thought of similarly to a Reverse Mortgage. It is an alternative way for seniors to tap into an existing asset to generate liquidity to cover immediate needs—but there are also important differences:

- **A Reverse Mortgage is a loan that must be paid back, with interest and fees, once the secured property is no longer the primary residence (a prohibitive requirement for someone seeking to move into a senior housing or care facility).**
- **A Life Settlement is the sale of a life insurance policy to a third party while the policy owner is still alive for a lump sum payment-- and since it is not a loan, the funds are unrestricted and require no repayment.**

The Long Term Care Crisis Grows

People seldom plan for a crisis and instead are forced to react to it when it is upon them. A recent study on how choices are made about senior housing and senior care showed three all too familiar patterns:

- 1. 13% actively plan for retirement and how they will live as they grow older and frailer**
- 2. 40% actively plan following a “near catastrophic” health event such as total joint replacement or extended illness**

3. 46+% never plan and must make decisions about site of care in a very short period of time, usually while still in the hospital

The problem is that the combined impact of our nation’s economic strains and people’s tendency to not plan and save threatens to sink the vast majority of people’s chances for quality “golden years”. Compounding the stress on the system is the fact that by 2020, the population of 65+ will increase 48% and the population of 85+ will increase 43%. The growth of the 65+ population will be attributable mostly to the aging of the Baby Boomers, but the growth of the 85+ population is primarily a factor of increasing life expectancy.

Currently in the U.S. there are over 1.5 million people living in nursing homes. Of that population, 72% are female and the 85+ population is growing the fastest with a 20% increase. The oldest old are living longer and they are costing more

than ever to support with private or public funds. This is important to consider when planning for the future because as of today, 56% of residents will live in a nursing home anywhere from one to five years or more (with a national average of 30 months).

For the population of 900,000 people currently living in assisted living facilities, the vast majority of financing is private pay. In addition to the monthly cost for a room, apartment or cottage; residents may also face one-time entrance fees ranging from \$60,000-\$350,000 for higher end “resort style” properties. Additional monthly fees ranging from \$348-\$522 are often times charged for transportation, dementia care, meal delivery to residence, and other extras that would add to quality of life.

As of 2000, the most recent year for data, there were 1,355,290 people receiving some form of extended home-based healthcare. Of that population, 70% were 65+ and 65% were female.

Fast Fact

Current national average costs across the three categories of long term care for 2008

Home/Community

- Non-Medicare Certified, Licensed “Companion” Care - \$18/hr (4% over 2007)
- Non-Medicare Certified, Licensed “Home Health Aide” - \$19/hr (3% over 2007)
- Medicare Certified “Home Health Aide” - \$38/hr (18% over 2007)
- Adult Day Health Care Center - \$61 per day

Nursing Home

- Semi-Private Room - \$187 per day (4% over 2007)
- Private Room - \$209 per day (2% over 2007)

Assisted Living Facility

- Private One Bedroom - \$3,008 per month (11% over 2007)

The average time span of care was for 312 days, and over 93% of the care was being delivered by Medicare/Medicaid certified agencies.

With the reality of these kinds of costs and the growing senior population; we will see increasing pressure on publicly funded programs such as Medicare and Medicaid (which combined pays for roughly 80% all long term care related expenses in the U.S.) and moves to make it more difficult to qualify. The long term care industry and the government at all levels are in agreement. More emphasis must be placed on the individual to pay for as much care and housing as possible with private funds before any public funds are made available. But what are some private funding options that people should be considering?

An obvious source of funds to cover these expenses would be from long term care insurance. The only problem is that tax deductions have never been established that would incentivize growth in the market, and it has been stalled for over a decade. As of today, long term care insurance accounts for an anemic single digit percentage of all funding for senior housing and care. That leaves private pay to pick up close to 20% of the approximate total of \$200 billion spent on all long term care service last year. But where do those funds come from if you have not saved literally hundreds of thousands in cash?

A primary option that people have often looked to is cashing in their home through a sale to raise the funds to sustain themselves (or to meet spend down requirements). But, the current real estate market has taught us, as is the case with the stock market,

that it is always vulnerable to a correction. Another means to extract equity from a home could be through a reverse mortgage, and it might be a good option for a home healthcare arrangement, but what happens if health conditions deteriorate rapidly and the person must move into a facility on short notice? The home owner is then faced with the dilemma of funds that can't be used for a setting outside of the home, and a loan that must be paid back immediately.

If a person has built up cash value in a life insurance policy, they could consider taking a loan against the policy or surrendering it for the cash value. Also, if someone attempts to qualify for Medicaid, a life insurance policy would be an “unprotected” asset subject to the 60 month look back period, and it would need to be liquidated and spent down on care before eligibility could begin. According to a Federal Government Accounting Office (GAO) report released to the U.S. Congress in March, 2007: when examining a sample population of over 500 Medicaid applicants entering long term care facilities, 38% owned a life insurance policy that needed to be liquidated because it exceeded minimum state mandated asset levels. Statistical data gathered on policies “settled” in 2007 continues to verify that the difference between the amounts of money that can be realized through a Life Settlement is significantly greater than through cash “surrender” value.

When cashing out a life insurance policy, either by choice or because of an eligibility mandate, the superior option is a Life Settlement. This process will ensure that the highest possible value is obtained for the policy through bidding from multiple institutional sources in the secondary market.

Also, any tax implications for capital gains realized from a Life Settlement would be offset by deductions based on spending the money for “the entire cost of maintenance in a nursing home or home for the aged” (sec. 1016 U.S. Master Tax Code 2008). When the time comes to look at funding vehicles to pay for long term care related expenses, cashing in a life insurance policy through a Life Settlement could be an excellent financial move.

Storm Clouds Begin to Clear

For seniors faced with the uncertain prospect of selling their home, securities or savings in such a down economy, Life Settlements are not only a chance to consider accessing an asset that will not fluctuate in value, but it is also an opportunity to liquidate a less dearly held asset. People obviously have a sentimental attachment to their home, stocks and other personal assets. This can cause delays in moving forward—but people have no sentimental attachment to an insurance policy and are more willing to liquidate it as a first option. If you can eliminate the reluctance seniors have about tapping into their most dearly held assets, and in the process eliminate the worry seniors have about outliving their money, then you can eliminate the delays in making a commitment to a course of action.

This is not just a financial tool—it is also a great marketing and relationship building opportunity by providing another option for prospective and current residents to find money to pay for residency and services. Properties are able to remove reasons for delay, and can provide peace of mind for seniors about prematurely running out of money. It is also another opportunity to

reach out to residents and prospects and show them that you are actively looking to work with them because you care about their well being.

How Life Settlements are Being Used to Pay for Senior Housing and Care

The majority of people who can be helped by a Life Settlement are first encountered during the admissions/registration process. People who are living independently and have recently encountered a pressing need to understand their options about the best retirement or long term living scenario, and how to pay for it, will be those most likely to possess some measure of financial means and own a life insurance policy. Typically social workers, the marketing department or the administrative/admissions office will be in a position to offer this as an option when people are considering their finances. There may also be some current residents that still own policies and need help raising money (and they would most certainly be eligible), but primarily it will be those living independently who have not yet altered their finances that will be most readily helped.

The process of a Life Settlement is straightforward and takes between 30-60 days—obviously much quicker than relying on the sale of a home. Remember, this is not a loan, not a government program and not long term care insurance—it is the sale of an asset through a competitive bidding process that will provide the policy owner with a lump sum payment for a far greater amount than the cash surrender value.

Once a policy owner sells their policy, they are no longer responsible for the premiums and they are free to use the money anyway they want. Also important to note is that there are absolutely no costs involved for the facility, and no up front fees or out of pocket expenses involved for the policy owner.

In the case of people entering a private pay arrangement directly or after a Medicare funded “short term” stay is over, how to raise enough money to last indefinitely could be one of the biggest emotional and financial challenges of their life. For those intimidated by the thought of selling their home or liquidating other assets to secure the funds they will need, a Life Settlement is a welcome alternative source of funds to access.

Anyone that owns life insurance and will rely on Medicaid to cover expenses associated with their care will be required to cash in the policy if its face value exceeds state mandated asset levels. The proceeds must then be spent down to cover the cost of care before Medicaid coverage can begin. If they decide to hold onto a policy, the beneficiaries could be subject to asset recovery efforts once the policy owner is deceased. The owner of a life insurance policy in this situation would be well served to explore the benefits of a Life Settlement. They could receive significantly more money than the cash “surrender” value that would be given to them by an insurance company-- and in turn sustain a private pay arrangement for a much longer period of time.

Conclusion: A Win-Win Scenario

According to the Society of Actuaries’ 2007 Retirement Survey: 60% of retirees worry about three things--

1. The cost of health care
2. The effect of inflation on their nest eggs
3. Not being able to maintain a reasonable standard of living for the rest of their lives

With today’s economy those concerns are well founded. There is billions of dollars worth of life insurance owned by people over the age of 65 today—tapping into Life Settlements as an alternative funding option for senior housing and care makes a lot of sense. Any chance to overcome financial hurdles preventing seniors from securing the best possible arrangement is in the best interest of the individual and their family, the facility and the government. Life Settlements are an easy to understand and straightforward financial tool to accomplish the goal of welcoming a resident who is able to afford living without fear of running out of money.

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Author Biography

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Chris Orestis held senior positions on a number of political campaigns before working in 1993 and 1994 for both the White House and the Senate Majority Leader on Capitol Hill. From that point, he spent the next several years representing the health and life insurance industry as Vice President and Senior Vice President respectively for the Health Insurance Association of America (HIAA) and the American Council of Life Insurers (ACLI). As senior management for both organizations, he was responsible for external affairs and activities related to revenue generation including membership, marketing, business and financial development, industry conferences, and industry-vendor coalitions/partnerships. In 1999, he was awarded the Robert R. Neal Medal by HIAA for distinction and service to the industry. Chris, a principal with Life Care Funding Group, is an acknowledged expert on insurance and long term care issues and is a featured columnist and Contributing Editor to a number of industry publications, including: *Insurance News Net*, *On the Risk*, *Society of Actuaries*, *HealthDecisions*, *ProducersWEB*, and *InsuranceIntell*. Chris Orestis can be reached at 888-670-7773 or by email at chris@lifecarefunding.com.

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