

Owner's Manual

Settling a life insurance policy.

BY **BILL DuBOIS**

Life insurance policies contain contract provisions that, in the proper circumstances, can offer benefits to clients beyond the lump-sum payment of policy proceeds. Some of those provisions have particular applicability to older policies. A careful review of the individual policy is required since the contract provisions vary greatly between insurers.

1. Interest Paid on Policy Proceeds Before a Claim Is Paid

Life insurance policy contracts and/or state law provide that an insurance company will pay interest on policy proceeds after the death of the insured person, either from the date of the insured's death, or from the date a claim is filed. In the latter case, the claim should be filed as soon as possible. But, when interest accrues from the date of death, it may be to the beneficiary's advantage to notify the insurance company of the insured's death but delay filing the claim papers. The purpose of the delay is to receive a higher-than-market rate of interest on proceeds.

Many older policies provide guaranteed interest rates of 2 to 3.5 percent, once-small rates that now are competitive short-term yields. Unless a beneficiary has an immediate need for the money or has an opportunity to invest the proceeds at a greater yield, it may be advantageous to delay filing of the claim paperwork to earn the higher rate of interest.

The guaranteed interest rate paid on proceeds before settlement varies by policy, insurance company, and state. The exact interest rate can be obtained from the insurance company if that insurer's claim information does not provide it.



2. Options for Payment of Policy Proceeds After a Claim Is Filed

A beneficiary may have the right to leave the policy proceeds with the insurance company and earn a guaranteed rate of interest. Policy provisions dealing with non-lump-sum payment of proceeds generally are found in the policy contract under a heading such as "Settlement Options," "Payment Plan Elections," "Payment of Policy Benefits," or some similar name.

One settlement option is "interest only." This allows the beneficiary to claim the policy proceeds but leave them with the insurer at either the policy's guaranteed interest rate or the insurer's current rate. Interest may be paid or credited monthly or annually, depending on the policy's terms. Each policy should be examined to determine which rate applies, when the interest is paid or credited, when the proceeds and accumulated

interest may be withdrawn, and whether a penalty is imposed when such a withdrawal is made.

Other settlement options may allow proceeds to be paid as an annuity-like life income, through principal and interest in equal installments over a specified number of years, and through a specified amount of principal and interest until the proceeds are exhausted. There likely will be tables in the policy itself that show what each of these options will pay at the guaranteed interest rate.

The policy's guaranteed interest rates used to calculate the payment amount under each of these options may be more favorable to a beneficiary than those available in the current market. In addition, the annuity rates used for life income options may be substantially better than those currently offered because life expectancies at the time of policy issuance may have been much lower.

Some policies may allow the direct beneficiary to add money to policy proceeds when electing one of the settlement options. There may be a fee and/or state premium tax for such an addition. However, it is wise to make a cost-benefit analysis to determine if a higher guaranteed interest rate more than offsets any such fee.

Except in certain life annuity settlements, any proceeds that are unpaid after the death of the beneficiary will be paid to other beneficiaries named either by the policyowner or the beneficiary.

3. Other Uses of Settlement Options for Beneficiaries

The policyowner, who usually (but not always) is also the insured, often has the right to designate settlement options for payment of proceeds to the beneficiary. In some cases, the

insured/owner's exercise of that right may be a cost-effective method for distributing policy proceeds to the beneficiary.

For example, if the beneficiary is elderly or infirm and either the amount of proceeds does not warrant creation of a trust or there is not a suitable trustee, the policyowner might provide through the insurance company that proceeds will be paid out over the beneficiary's lifetime. Such an arrangement protects a financially inexperienced beneficiary from dissipating the proceeds and from those unscrupulous persons who prey on the elderly.

Proceeds paid in a non-lump sum can be settled using two or more options to preserve financial flexibility. For example, a portion of the proceeds may be settled under an "interest only" option, which gives the beneficiary a

right of withdrawal to some or all of such proceeds, while the remaining proceeds may be settled under a different option, such as a life income or payment over a period of years.

4. Use of Settlement Options for the Insured Client

Most policies allow payment of policy cash values using the settlement options in the policy to benefit the policyowner. Once again, a policy's guaranteed interest rate and/or guaranteed annuity rates may be much better than the rates currently available. **TBJ**

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