

Unlocking the Benefits of a Life Settlement Auction

Selling unneeded life insurance policies on the secondary market can create cash for planning needs without disturbing other investments

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An auction house appraises high-value assets such as jewelry, fine art, collectibles and other tangible properties and presents them to qualified bidders. Life insurance is considered an intangible asset, and some go as far as to call it invisible. The only tangible thing you receive when you purchase life insurance is a copy of the policy, which will show you how the policy is expected to perform on both a guaranteed and projected basis over time. It will also state the death benefit and any surrender value at a given point in time.

Over the past two decades, a reliable secondary market for life insurance has emerged with an auction process that can uncover a policy's fair market value (FMV), which can be vastly different from its current cash value. Life insurance is an asset your clients own. When was the last time it was appraised? Like your clients' other ordinary property, it is important to value their life insurance property before they materially change it or terminate it.

Life Insurance Is an Overlooked Asset

Life insurance is an asset that is often not a line item on a balance sheet or recognized as a piece of property that a client owns. It should be treated like any other asset such as real estate, art or jewelry – before your clients decide what to do with it, it should be valued. The landscape for life insurance has changed over the last several decades. There are a variety of products and policy types that your clients can choose from based on their planning needs. All policy types can qualify for sale in the life settlement market; however, universal life products are the most attractive to the institutional buyers. There are guaranteed, flexible premium adjustable life, indexed and variable policies. These policies usually do not build significant cash value, and they require an ongoing premium to keep the face amount in force. Convertible term policies can also be good policies for the market. Before your clients surrender or lapse a policy, having the policy appraised could identify if it is worth more than its surrender value. The FMV of the policy can impact balance sheet reviews, business valuations, marital disputes, transfer for value situations and, of course, an estate auction process. Do not allow your clients to overlook this asset.

The Life Settlement Auction

Over the past 20 years, regulation and transparency have increased in the market, resulting in the life settlement option being available in all states. There are specific licenses for the parties that represent the policy owner and for those that represent the investor. These two licensed parties are the life settlement broker, who serves as the seller's representative, and the life settlement provider, who serves as the buyer's agent. The broker is 100% aligned with the policy owner and has a duty to provide transparency and a best practice approach to the market. The broker's role is to craft the strongest negotiation possible, interview and bring qualified institutional buyers to create a marketplace, and deliver the highest FMV for the life insurance policy. Brokers do this by managing a life insurance policy auction that puts providers that purchase policies in competition with each other, forcing them to bid against one another to purchase the insurance policy from the policy owner. Like other property sales, competition drives more value to the seller. Knowing the different market participants and ensuring your client is aligned with a party that represents them in the auction is very important.

Where to Identify At-Risk Policies

If you are working with retirement-age clients or persons who sit on the boards of companies or charities, integrating the policy review and valuation of their life insurance assets can have meaningful results. With the changing landscape, many policy owners do not understand the insurance they own or how the products vary in their premium needs. Universal life policies require the most management. Many of these policies have been severely impacted by a sustained low interest rate environment. What happens to an irrevocable life insurance trust (ILIT) that is holding a UL policy if the agent who sold the policy has since retired or is deceased? Who is managing the policy performance? What happens if the insured is living much longer than expected and premium requirements are increasing dramatically? It has been our experience that most ILIT trustees, planned-giving departments of charities and businesses do not routinely appraise their policies.

Imagine a decision made by an ILIT trustee to discontinue paying premiums because they were escalating and too expensive. According to a Wharton School study, “almost 85% of term policies fail to pay a death claim; nearly 88% of universal life policies ultimately don’t terminate with a death benefit claim.” Many of these low cash value policies were forfeited back to the insurance company for their cash surrender value without anyone in the planning community asking for an appraisal to determine FMV. If you have retirement-age clients with UL or convertible term policies, you could protect them from a costly mistake by checking for any potential life settlement value. Your client will need to submit medical records for the past five years, but no paramedic exam is needed.

“Always secure a qualified appraisal of your clients’ existing life insurance prior to making any material changes to a policy.”

The types of institutional capital purchasing life insurance policies are private equity, hedge funds, pension funds, large multifamily offices and asset managers. They are interested in all policy types and face amounts. The market on average produced five times the surrender value for viable policies and created \$640 million in cash flows above surrender values for policy owners who sold their policies in the market.

Experience and Alignment Are Critical

Ask the following questions when choosing a life settlement resource to identify FMV and manage the policy auction:

- Are you a licensed broker who manages a policy auction forcing all providers/buyers to compete while acting as a fiduciary to the policy owner?
- How much experience do you have in the settlement market? Are life settlements your core business? How many life settlements have you completed in your career?
- Will you disclose your pricing, value analysis and longevity underwriting to select life expectancy estimates?

Ensuring your clients have independent seller representation, which will force competition among multiple buyers, will help protect you and your clients in a life settlement transaction. Recognizing life insurance as an asset that can help clients with retirement, wealth preservation, long-term care, bankruptcy, divorce, and charitable and other financial planning needs adds a new dimension to your client discussions.

CASE STUDIES OF POLICY OWNERS WHO SOLD THEIR LIFE INSURANCE

FUNDS NEEDED FOR LONG-TERM CARE (LTC)

“For the first time in years, I feel like I have my dignity back.”

- Female, Age 80
- \$500K Guaranteed Universal Life Policy
- \$6K Cash Value
- Life Settlement Value = \$197K after 12 bids

INCREASED LONGEVITY

“The life settlement gave me the ability to maintain my lifestyle in retirement.”

- Male, Age 87
- \$5M Universal Life Policy
- \$386K Cash Value
- Life Settlement Value = \$1.65M after 34 bids

RETIRING BUSINESS OWNER

“The life settlement of my term policy resulted in liquidity beyond the sale of my business.”

- Male, Age 72
- \$5M Convertible Term Policy
- \$0 Cash Value
- Life Settlement Value = \$750K after 18 bids

DONATION TO CHARITY

“I was able to donate to the charity I love without disturbing other assets.”

- Female, Age 85
- \$3M Survivorship Universal Life Policy (one deceased)
- \$48K Cash Value
- Life Settlement Value = \$1.1M after 34 bids

PLANNING TO SURRENDER THE POLICY

“We eliminated future premium payments and received a large amount of cash from something we were about to just let go.”

- Male, Age 78, and Female, Age 77
- \$2.5M Survivorship Universal Life Policy
- \$26K Cash Value
- Life Settlement Value = \$612K after 24 bids