Robin & Peter on LIFE SETTLEMENTS

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Sell Now or Sell Later?

Once a determination has been made to sell a policy because it is no longer wanted, needed or affordable, a second decision frequently arises. Should the policy be sold immediately or at some future time? This question often comes up when a policy still has cash surrender value and is capable of staying in force for a period of time without additional premium outlays.

A typical scenario might be a $1 million U.L. policy with $40,000 of cash surrender value and, according to an in force ledger, the policy would not lapse for about 2 years if no additional premium payments are made.

Unfortunately, in this scenario the wrong conclusion, to wait two years, is often reached by focusing on the projection that there is no additional outlay required. This analysis, unfortunately, treats the two year delay as “free” insurance. While the policy doesn’t require further premium outlays to stay in force those two years, the coverage is anything but free. Consider if a life settlement were not available and the policy could only be surrendered. By waiting two years the cash surrender value will likely go from $40,000 to near zero – this is hardly free insurance.

A similar thing happens when a life settlement is an option. A very significant factor in the pricing of a life settlement offer is the cost to carry the policy going forward. When a policy has some cash surrender value, those funds reduce the life settlement buyer’s cost to carry. So a life settlement offer of $100,000 for a policy with $40,000 of cash surrender value could turn into a $60,000 offer on the same policy if there were no cash surrender value.

Though significant, the reduction of the cash surrender value, however, is not the only factor that might impact a life settlement offer in the future. Some of these factors may increase the offer and others may decrease it. Life expectancy, for example, is another major factor in life settlement pricing.

While an individual's life expectancy is, of course, expected to decline over time, without a change in health, the life expectancy does not decrease at the same rate as the time that has passed. For example, a person with a current life expectancy of 10 years, may still have a life expectancy of 8 years, even after the passage of 3 years.

Additionally, the mortality tables used by life settlement actuaries have shown steady increases in life expectancy. While the more general population mortality tables have decreased most recently as a result of the opioid crisis, the mortality tables used for life settlement population have not. So by waiting, an insured may become subject to a life expectancy increase based on a revision to the life settlement mortality tables; although the reverse is possible, it would be bucking the trend.

If the insured decides to postpone the decision and their health declines while waiting, and their life expectancy decreases meaningfully, they might receive a much larger offer. Waiting allows the policy owner to assess things at a future time. They may speculate on a possible decline in health which would make the policy worth more or, if that occurs, even more attractive to keep it rather than to sell. But note, however, there may well be a cost for the delay.

If the decision is to wait, be sure **not** to allow the policy to go into the grace period or lapse. A life settlement transaction can take up to 3 months or more to complete. Investors don't buy policies in the grace period or policies that have been reinstated within 2 years as that starts a new contestable period. Careful monitoring is required.

Finally, another major factor in life settlement pricing is the condition of the life settlement market as a whole. A change in investors' target rates of return can substantially increase or decrease a life settlement offer.

When it comes to health and to market conditions, no one has a crystal ball. Yes, holding on to a policy longer does give the owner more time to make a decision and possibly speculate or reconsider based on an adverse change in health or market influences; however, the decision to wait frequently does come at a price.

The bottom line is that it is important to understand that there is no free ride when waiting. The decline in cash surrender values or possibly additional premiums that might have to be paid to keep the policy going are real considerations. If the prime objective is to maximize cash from the policy, quite likely the best approach is to sell as soon as the decision is made that the policy is no longer wanted, needed or affordable.

As situations come up, please be sure to give us a call. We will be glad to help you determine if there is one more opportunity to do something good for your client.

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