LIFE SETTLEMENTS

SHOULD YOU WAIT TO SELL YOUR LIFE INSURANCE POLICY?

The purpose of this article is to help you evaluate the optimal timing for selling an unwanted or unaffordable life insurance policy to a third party through a transaction called a life settlement. This article considers the core factors that may affect the value of a policy over time.

EXECUTIVE SUMMARY

- Existing insurance policies are subject to change based on the insurance company's discretion. Future changes, such as a reduced crediting rate, could result in increased premiums for the policyowner and reduce the value of a policy over time.
- Historically low interest rates and desire for alternative investments are increasing investor demand to purchase policies. The influx of capital and limited policies available for purchase is resulting in strong life settlement offers for policyowners.
- The primary factor that determines the life settlement offer is the life expectancy of the insured.
- An insured's life expectancy typically decreases slower than their actual aging, which means waiting to sell a policy is rarely in the policyowner's best interest when coverage is no longer needed.
- Auctioning a policy using a life settlement broker continues to be the only way to receive fiduciary representation and confidence in obtaining high fair market value for policyowners.

If you discovered your unwanted life insurance policy has value and can be sold, naturally you may be wondering if this is the right time to sell your policy. After all, if your policy has value now, won't it have a greater value in the future?

The answer depends on several factors, such as future policy performance and changes in the insured's health. Whether you are a policyowner, or a professional helping your client navigate the financial decision of selling their policy, the following factors should help make the determination if today is the right time to sell your policy.

FACTORS THAT WILL AFFECT THE FUTURE VALUE OF YOUR LIFE INSURANCE POLICY

Future Policy Performance

An insurance policy is a contract that is made up of both guaranteed and non-guaranteed components. You are guaranteed to receive the death benefit so long as the cash value performs as intended, all premiums are paid, and all additional requirements are met (as spelled out in the contract). The cash value performance is based on nonguaranteed assumptions, such as a certain market return or carrier crediting ratings. If your policy doesn't perform well, you may be surprised to receive a notification to pay a significantly higher amount of premium to maintain the policy in its later years.

If the assumptions of your policy change, such as a reduced crediting rate by your carrier, or an increase in expenses, the policy may be worth less than it was prior to the change. Due to prolonged low interest rates, many carriers have been reducing crediting rates or raising the COI (Cost of Insurance) which is hurting the value of the policy.

Changes in the Life Settlement Market

Like all markets, there are periods that are a buyers' market, and other times it's a seller's market. Many buyers today are looking for alternative investments where they can earn a return on an investment that is less correlated to the stock market. In 2008, the buyer capital largely dried up and sellers were unable to receive strong offers for their policies. Today, there has been an influx of capital and more buyers – which increases demand and results in competitive offers. It is challenging to forecast how the market will be in the future, but the high level of buyer demand for policies today is favorable for those selling their policies.

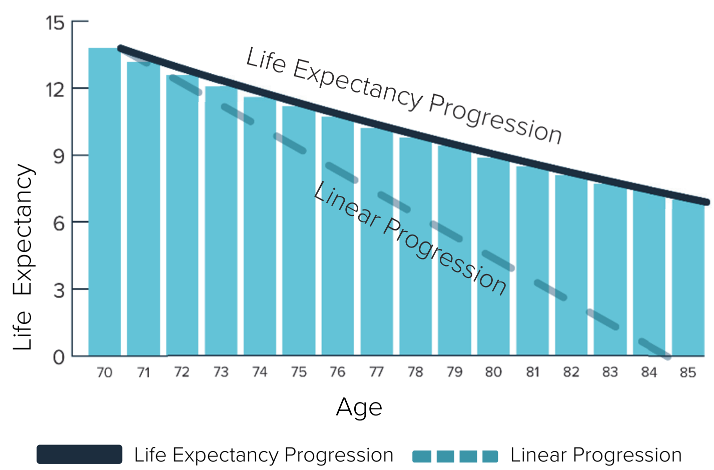
Future Health of the Insured

The future health of the insured is likely the most significant factor that will affect the market value of a policy. Buyers make offers on policies based on how long they expect to pay premiums and wait for the death claim to take place. They estimate longevity of each insured based on third-party Life Expectancy (LE) Reports.

An LE report is based on actuarial science, and considers the insured's age, lifestyle, habits, and health conditions and compares them to other individuals who had similar conditions in the past. While the LE report is used to determine average life expectancy, it is not a crystal ball that determines exactly how long the insured will live.

Your life expectancy over time is not exclusively correlated with age. In other words, if you are one year older, and are in a similar health condition, your LE will not decrease by a whole year.

The following chart shows the progression of a male's life expectancy over 15 years assuming similar health conditions. Note that his life expectancy does not decrease as fast as he ages.



Notice in the previous chart that while this individual has aged 15 years, his Life Expectancy has only been reduced by about 6.8 years in that same period.

It would be expected for any individual with similar health conditions that their life expectancy would decrease at a rate slower than their actual aging.

Because a life settlement offer is significantly tied to the insured's life expectancy, and life expectancy decreases slower than actual aging, waiting to sell a policy is rarely in the policyowner's best interest.

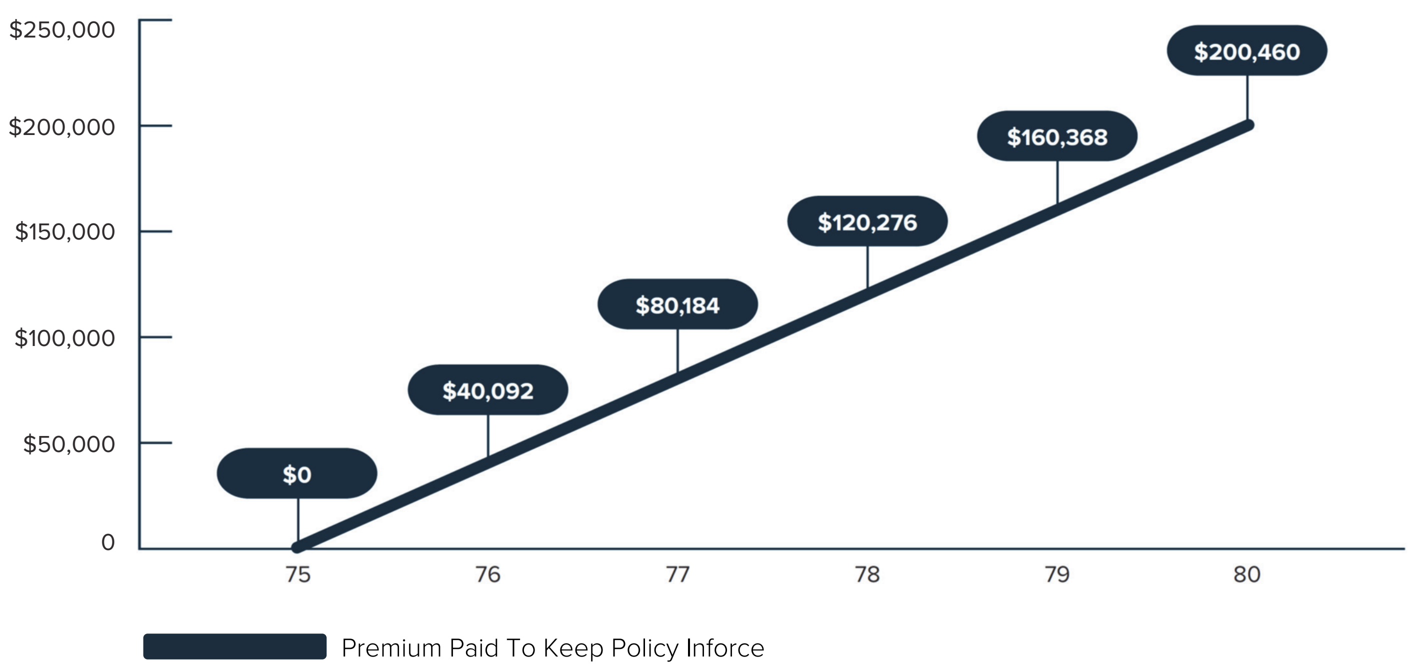
Said another way, waiting to sell your policy will typically only be a profitable decision if the insured's health declines faster than the average population with similar health conditions.

Case Study: Should I Sell My Policy?

In 2020, Robert Smith, age 75, owned a $1,000,000 Universal Life Policy, obtained a 11.7-year Life Expectancy report, and after auctioning his policy, received a high market value of $162,500. Robert considered the pros and cons of waiting a few more years to sell his policy. To maintain his policy, Robert would be required to pay $40,092 a year in premium to keep the policy in force through his life expectancy.

The chart below shows the cumulative premiums required to maintain the contract over the next five years. We then projected what his life settlement offer may have been if he waited to sell, based on his projected life expectancy during the same five-year period. This projection assumes no significant changes in his health and the market conditions remained the same.

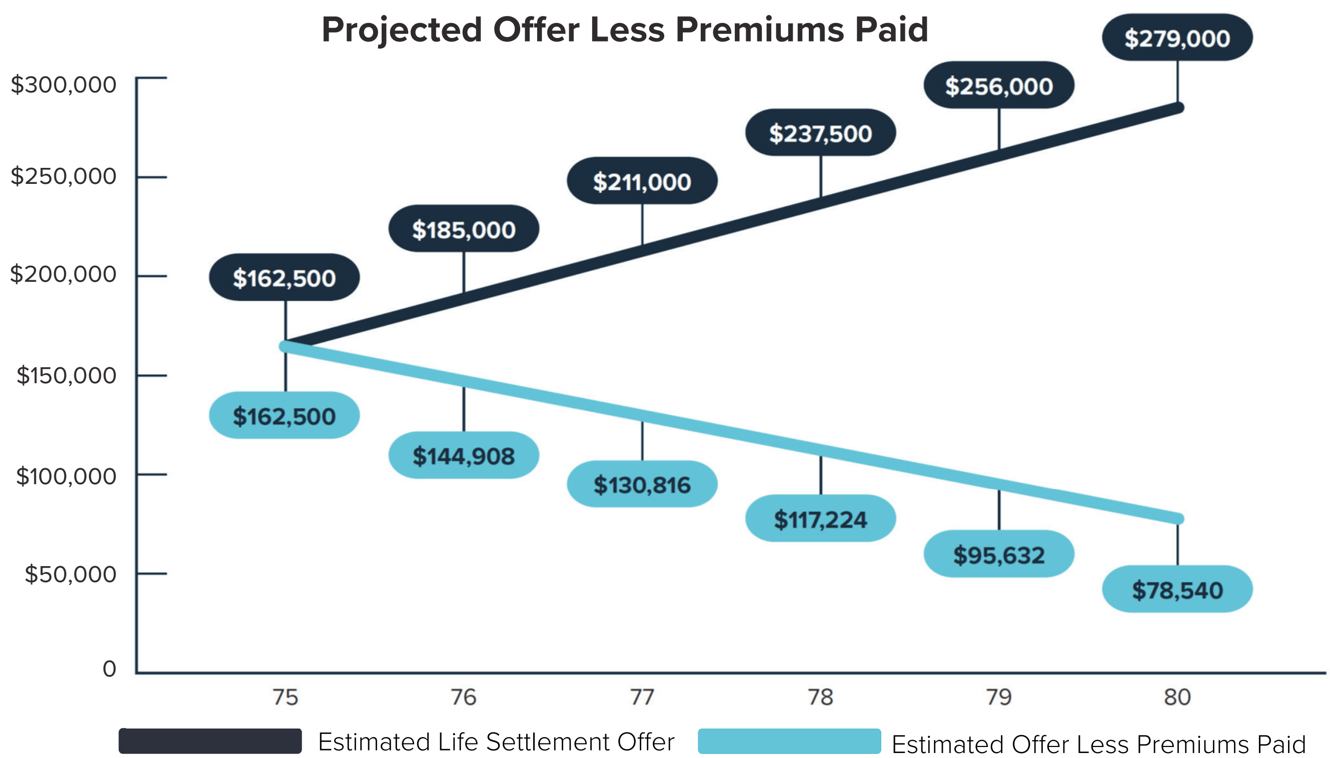
Cumulative Premiums Paid Over the Next Five Years



Note: This example illustrates Robert funding the policy in a way that maintains his policy through his life expectancy estimate.

The next chart below shows the estimated offer over time (above line), and compares it to the net offer (below line), which is the estimated offer less premiums required to maintain the policy. Notice that while the offer increases over time, the premium payments outweigh the increase which results in less total dollars to Robert by waiting.

In addition to the reducing net offer over time, you should consider the additional value of what the money could have been used for if sold. Could those funds be invested for further gains? Or used to solve an immediate cash flow need such as retirement or health care expenses?



Note: These projections assume similar market conditions over the next 5 years.

Final Considerations

There are multiple factors that may affect the value of your policy in the future, such as policy performance, market conditions, and the insured's health over time. By selling now, the risk factors are placed on the new buyer. A family should ultimately discuss the value of holding the insurance policy with the reality of continuing to pay premiums to maintain the policy. What if the insured lives longer than expected? Does the policyowner have the liquidity available and willingness to maintain the policy?

An Advocate in Your Corner

If you determine that now is the time to sell your policy, having an advocate represent your best interests is crucial to obtain high fair market value. Acting as a fiduciary exclusively to the policy owner, our life settlement process creates an efficient market by presenting the policy to a large network of 18+ of the industry's top buyers and launching a competitive auction process. This often drives up the offer as buyers bid against each other until a high fair market value is achieved.

We have expertise to make the process easier – from estimating fair market pricing on the policy, obtaining all medical, life expectancy and policy information, to coordinating an auction and managing the closing process. At the end of the auction, we provide a comprehensive analysis that will help you decide if it makes sense to sell. There is no obligation to sell by applying. We have helped clients receive over $200 million dollars of proceeds in the past 15 years and look forward to being your advocate if you decide to sell your policy.

Valmark Securities, Inc. (Valmark): Valmark and its registered representatives act as brokers on the transaction and will receive a fee from the purchaser. Valmark supervises all life settlements like a security transaction.

Life Settlement Providers: Valmark markets policies only to Life Settlement Providers. Life Settlement Providers are generally responsible for maintaining the policy after sale, and receive their funding from institutional buyers. Valmark reviews Life Settlement Providers periodically to affirm that their funding sources are institutional buyers, carry errors and omissions insurance, and are licensed in the state of sale.

Institutional Buyers: Institutional buyers include qualified institutions, accredited investors, hedge funds, pension funds, and other qualifying investors. Investors bundle policies to ease any concerns with strangers having access to view millions of death benefit on an individual.

In a life settlement agreement, the current life insurance policy owner transfers the ownership and beneficiary designations to a third party, who receives the death proceeds at the passing of the insured. As a result, this buyer has a financial interest in the seller’s death.

A policy owner should consider the continued need for coverage, and, if the policy owner plans to replace the existing policy with another policy, the policy owner should consider the availability, adequacy and cost of comparable coverage.

Policy owners considering the need for cash should consider other less costly alternatives to a life settlement.

When an individual decides to sell their policy, they must provide complete access to their medical history, and other personal information, that may affect their life expectancy. This information is requested during the initial application for a life settlement.

After the completion of the sale, there may be an ongoing obligation to disclose similar and additional information to the buyer or servicing agent at a later date.

A life settlement may affect the insured’s ability to obtain insurance in the future and the seller’s eligibility for certain public assistance programs, such as Medicaid, and there may be tax consequences.

Individuals should discuss the taxation of the proceeds received from a life settlement with their tax advisor.

A life settlement transaction may require an extended period of time to complete. Due to complexity of the transaction, fees and costs incurred with the life settlement transaction may be substantially higher than other securities.

Once the policy is transferred, the policy owner has no control over subsequent transfers.