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UNDERSTANDING THE FAIR MARKET VALUE OF A LIFE INSURANCE POLICY

When a professional advisor identifies a life insurance policy that a client no longer needs or wishes to maintain, he should ask, as standard protocol, whether that policy may have value in the secondary market.

If so, the client may be able to sell the policy in a life settlement transaction, enabling him to receive a higher cash payout than he otherwise would obtain by lapsing or surrendering the policy back to the insurance company.

But in order to help advise a client on how to proceed, an advisor needs the answer to the following elusive question:

How is the fair market value of a life insurance policy determined?

Factors That Contribute to Valuation

There are a number of variables that impact the value of a client's life insurance policy. The most significant factors are:

1. Face Value
The amount of death benefit that the policy will pay out when the client passes away;

2. Cost of Premiums
The amount of money that a buyer will need to pay in annual premiums to keep the policy in force;

3. Cash Value
The amount of cash that has accumulated inside the policy and the interest rate that is being paid on this amount, adjusted for any outstanding loans against the policy;

4. Life Expectancy
The age, health status and projected life expectancy of the insured to establish a baseline for how long the policy will need to be kept in-force by a buyer; and

5. Policy Type
Universal Life, Whole Life, Variable Life, and Term Life policies all have unique characteristics that affects their marketability.

Once this information is in the hands of qualified prospective buyers, they will determine whether to extend an offer for a policy. If they choose to proceed, it is important to understand and recognize the following: buyers do not like competition for assets (policies) they wish to purchase.

Competition drives purchase prices up. Life settlement brokers create such competition.

Determining Fair Market Value

When buyers purchase a life insurance policy directly from consumers or via exclusive referrals from advisors, they are eliminating an experienced life settlement broker from the transaction. This opens the door for the policy to be purchased at a lower acquisition cost since there are no other buyers with whom they must compete. In this scenario, the client, in all likelihood, is not receiving fair market value for his policy.

To determine the true “fair market value,” the best place to start is with a trusted definition. The Internal Revenue Service, charged with establishing valuation, defines the term, in part, as follows:

“Fair market value (FMV) is the price that property would sell for on the open market. It is the price that would be agreed on between a willing buyer and a willing seller, with neither being required to act, and both having reasonable knowledge of the relevant facts.”

There are three key elements of this definition that apply in a very practical way to life settlement transactions.

First, determining fair market value requires the discovery of what the property would sell for on the open, competitive market. One buyer and one seller is not an open market; instead, it is a limited market that does not account for competition. Accessing the open market in the life settlement industry requires shopping a policy to multiple if not all qualified, licensed buyers in the seller’s home state. A life settlement broker fulfills this role.

Second, determining fair market value requires that neither party is required to act. Buyers often have the financial resources to pressure sellers to act fast in order to avoid paying the next burdensome premium payment or to receive a cash payout as soon as possible. This often results in the seller accepting the first offer extended, without regard to whether such an offer is fair.

Third, determining fair market value requires that each party has knowledge of all relevant facts. Most sellers and their advisors have no personal experience or knowledge about the factors involved in determining the present-day value of a life insurance policy. This lack of knowledge can cause a seller to unwisely accept an offer that is below the fair market value of the policy.

Conclusion

The only way to arrive at fair market value for a life insurance policy is to have someone represent the best interests of the seller. Life settlement brokers are obligated by state regulations to represent such interests in an honest and ethical manner and they create the necessary competition to determine what the policy is truly worth.

The fair market value of a life insurance policy cannot be determined if the seller is under pressure; does not have access to an open, competitive marketplace; has no knowledge of how the asset should be valued, and is not informed of the relevant factors involved in determining its price.

The easy solution is to work with an experienced life settlement broker, who understands the asset class, has access to the open market and understands how to maximize the value of a policy.

Ready to get started?
Contact the Larry Gordon Agency today!
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Since 1965 the Larry Gordon Agency, Inc. has been synonymous with performance and expertise. TeamLGA specializes in multiple carrier management, aggressive impaired risk underwriting and an extensive annuity portfolio.

LGA is working with Coventry to help bring life settlements to more Americans. Coventry created the secondary market for life insurance, coining the term “life settlement” to describe the transaction that enables policyowners to sell their unneeded life insurance policies. For more than 20 years, Coventry has been the life settlement market leader; driving the industry forward and expanding opportunities for policyowners. Since its founding, Coventry has completed more than $40 billion in longevity-linked transactions.

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