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### Uncovering Hidden Assets in Valuations

Life insurance is an asset class. Should you be the one to put it on your client's balance sheet?

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by Igor Zey, CLU/ChFC

More than ever, today's turbulent economic climate requires that advisers to families and their businesses, whether healthy or troubled, proactively manage their finances and maximize the value of their assets and estates. Life insurance policies, whether individually or trust-owned, have long been an integral part of estate and multi-generational wealth planning as well as playing a vital role in the corporate world as a key person policy or involved in buy-sell agreements.

Although this arrangement can be a highly effective means of offsetting estate taxes or the financial impact associated with the sudden passing of a key executive, the policy often is overlooked in a divorce and is treated as "just the CSV" (cash surrender value) on a permanent policy or simply "thrown away" if it is a term policy. However, monetizing these assets can assist in freeing up additional hard assets as well as provide cash-flow, thus potentially helping bridge the gap on a divorce settlement or financing the family business through a troubled time. Given this, CPAs and attorneys should evaluate their engagements to ensure that these "hidden assets" are successfully uncovered as they are often overlooked and treated solely as an expense and not as the valuable and saleable asset that they may be.

#### Example 1: Value of the policy for Divorce Settlement Purposes

- **Type of Policy:** Universal Life
- **Gender:** Male
- **Age:** 73
- **Face Amount:** \$1,500,000
- **Premium:** \$79,000
- **Net Cash Surrender Value (CSV):** \$195,000
- **Gross Offer to Client:** \$314,000
- **Increase From CSV:** \$119,000

**Case Summary:** Through competitive bidding, the owner of the policy secured a gross offer of \$314,000 for the policy.

The reality is that life insurance has long been priced by the insurance carriers on the statistical reality that a sizeable share of policies would be allowed to lapse because the customer could no longer afford the premiums or no longer needed the coverage. Until recently, there were just three options for the policy owner who desired or required an exit strategy:

1. Allow the policy to lapse, by discontinuing future premium payments;
2. Continue to pay the premiums and keep the policy in place; or
3. Surrender the policy to the issuing insurance company for the cash surrender value (CSV).

The CSV typically is not an accurate reflection of the fair market value of a policy and, with the emergence of the life settlement option, it is not uncommon for the policy owner to realize three to five times the CSV through the sale of a policy in the secondary market. Life settlements are being used for many reasons such as providing the necessary funding required to obtain a more contemporary policy, funding dependent care/immediate needs and to achieve other complex financial planning goals.

#### How Does It Work?

##### *Mechanics of a Life Settlement*

A life settlement is the sale of an existing life insurance policy by the current owner to institutional investors, such as commercial and investment banks, pension and hedge funds, or insurance companies. These investors (including Goldman Sachs, Deutsche Bank, JP Morgan Chase, Credit Suisse, among others) assess the fair market value of these policies and purchase them for a one time lump-sum payment to the policy owner and subsequently assume responsibility for the payments of all future insurance premiums.

All policy types, including universal life, variable universal life and even convertible term policies are eligible for a Life Settlement. In fact, term policies, which are often viewed as not having any value because they do not accrue CSV, may prove to be the most valuable of these hidden assets. Due to the fact that there is no CSV, they are often cancelled or even worse, allowed to lapse for non-payment. However, more than 90 percent of term policies contain a conversion feature, which provides the owner with the right to convert from a term policy to a

permanent policy. Upon exercise of the conversion right, the owner can then consummate a life settlement transaction and extract value from the asset.

**Example 2: Key Man Insurance — Business Valuation issue**

- **Type of Policy:** Term Life
- **Gender:** Male
- **Age:** 68
- **Face Amount:** \$4,000,000
- **Premium:** \$175,000
- **Net Cash Surrender Value (CSV):** \$0
- **Gross Offer to Client:** \$425,000
- **Increase From CSV:** \$425,000

**Case Summary:** This case involved a 68-year-old husband with a business that owned \$4,000,000 of term coverage on his life. The policy would be worthless once it expired, so the opportunity to turn nothing into something was very intriguing to the owner. By having the proper conversion illustration issued, the policy was able to be marketed to multiple purchasers. Through a competitive bidding process the owner received a gross bid of \$425,000.

To qualify for the life settlement option, the general rule of thumb is that the insured must be over 65 years of age, and have at least \$500,000 of life insurance coverage. In addition there are other factors, including age, gender, health of the insured, and the size and type of the policy that influence the ultimate purchase price of the policy.

The life-settlement process is relatively simple. It's strictly paperwork. An application is signed, medical information is collected, life expectancy reports and policy information are gathered and these items are sent out to the market. At that point, a life-settlement broker can conduct an auction-like process in which bids are presented to the broker for acceptance, a process which the broker should handle on a contingent basis.

**Conclusion**

Advisers have a fiduciary obligation to maximize the value of their clients' estates for the benefit of all parties involved. In scenarios where insurance assets exist, the policy should not be arbitrarily surrendered for the CSV or allowed to lapse without an appraisal of its true market value. Advisers should consult an experienced life settlement broker, who has significant knowledge of the ever changing marketplace in order to obtain the highest monetary value for these assets. Even in situations where the policy has positive CSV, a life settlement should be considered as it often provides significant cash influx at exactly the right time whether due to a divorce, M&A of a family business, succession planning, or bankruptcy scenarios.

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