Policy Lapses

Every week we field enquiry from advisers and policyholders about cashing out a whole of life or endowment life policy.

In some cases there are debts attaching to the policy, and the reason for cashing out is to avoid further deterioration in the net cash value. Typically, the policyholder cannot repay or even service the policy debt and are looking for the best possible outcome under the circumstances.

But we know from industry stats that enquiries we receive are just the tip of the iceberg.

Covered in this issue:

1. Industry Statistics - Early Terminations A Significant Proportion Of Policy Discontinuances
2. Policy Debts - Helping Clients Before It's Too Late
3. Cashing Out Lapsing Policies – Case Studies

Industry Statistics

A review of Financial Services Council industry data over the 12 months to Sept 2019 provides insight as to the level of 'early terminations' currently occurring.

The number of in-force conventional contracts as at 30 Sept 2019 was 184,631, down by 10,900 from 12 months earlier. This is roughly in-line with the drop off in conventional business over the previous 3 - 4 years. This is not unexpected given the ageing nature of this book of business.

The data becomes more interesting when analysing what the reduction in policies is made up of. Using the drop-off in annual premium income (by category) over the period we can approximate how many policies ceased as a result of 'natural' events (maturities and death claims) and how many were due to 'early termination' (lapses, surrenders and cancellations).

We found the following:

- 55% of policies, by API, ceased as a result of 'natural' events
- 45% of policies, by API, ceased as a result of 'early termination' events

Almost half of policies are ceasing early. Unfortunately, there's no further data to determine the mix of 'early terminating' policies.

Anecdotal observations

We're seeing some policyholders cash in to clear their mortgage prior to retirement, while others already in retirement want to free up cash to support themselves. In the context of planning for retirement it's perhaps not surprising that managing existing policy debts is a low priority, and a possible reason why some policies lapse.

We also know this is an ageing group of policyholders (average age guesstimate between 55 - 65).

It's clear retirement related issues are a key trigger point for 'early terminations'.

For advisers, proactively engaging with clients close to or in retirement, as well as those with policy debts showing up on your reports will help you offer the best possible outcome for your clients.

Policy Debts: When to Help Clients

Premium and loan debts can spiral out of control quickly. Cost of funding charges applying to policy debts is currently 2-3 times the long-term growth in cash value for the average whole of life policy. At some point the $ increase in policy debts will exceed the $ increase in surrender value. Not taking action diminishes the net cash payout, and the older the policyholder the less likely they may be to start repaying, with retirement planning coming into focus.

At what point should I consider discussing with my client?

Early Warning Trigger Points

- If cost of funding charges = 2 x the long term expected cash return, then it's time to take action at a debt:surrender value ratio = 50%.
- If cost of funding charges = 3 x the long term expected cash return, then it's time to take action at a debt:surrender value ratio = 33%.

The action taken will depend on the level of debt and the client's ability to service or repay it. If policy debts are still at a reasonably low level, a repayment programme can be initiated to keep the net cash value from falling back further. Where debts have increased to a much higher percentage of the gross surrender value (and lapsing imminent) it's often hard for policyholders to see a way out.

But the good news is that advisers can still add value even when policies are about to lapse.

Cashing Out an Indebted Policy: Some Examples

Irrespective of the level of debts Policy Exchange is happy to complete an evaluation.

Any enhancement we offer is a % of the gross surrender value – it's unaffected by the level of policy debt. If the client agrees to sell to us we'll clear the debts with the life company to keep the policy in-force.

Examples of policies sold to us with debts

Below are examples of some of the indebted policies we've traded.

	Policy 1	**Policy 2**	**Policy 3**
Gross surrender value	$74,853	$59,415	$14,399
Policy debts	$54,979	$44,748	$10,569
Net cash value via life co.	**$17,684**	**$14,481**	**$3,855**
Enhancement	$3,046	$1,767	$681
Our payout to the policyholder	**$20,730**	**$16,248**	**$4,536**

If you have a client with debts against the policy unlikely to be repaid, try our online Quick Calculator to see how much more they could get by selling than surrender. And remember Policy Exchange also pays a referral fee to the referring adviser.