'STORM' HITS LIFE INSURERS

Low interest rates, squeezed profits and longer life spans have created a "perfect storm" for life insurance firms and their policyholders.

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When the stock market plummets, wise investors take action to ensure their assets are diversified and their losses minimized. Life insurance policies should be treated with the same careful attention.

That is especially true now, because the insurance industry and policyholders are in the midst of a "perfect storm," with historically low interest rates, rising life spans and rising insurance costs merging to impact the value of permanent life insurance policies.

As an advisor, here is one important thing you need to know: Five insurance companies raised rates in 2015, some by 100% or more.

We've been recommending policies to clients for years and this is the first time we've seen this type of shift. It's not due to corporate greed. Several factors have contributed to these powerful winds of change, and it's led to significant rate increases for many consumers.

Here are the main trends influencing the changes:

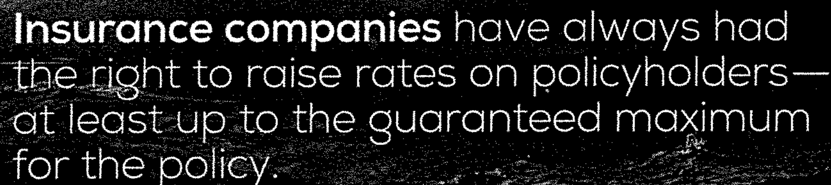
1. Interest rates have been declining and have been at historic lows for over a decade.

Unfortunately, economic factors are working against insurance carriers when it comes to providing consistent income. Insurance carriers don't earn their revenues primarily from premiums. As much as 50% of their revenue comes from interest-bearing securities, primarily bonds and mortgages. So low interest rates have a direct impact on insurance company profitability.

2. Squeezed policy crediting rates. Insurance companies price life insurance products with interest margins of 25 to 100 or more basis points, and these have been squeezed and in some cases gone negative. As crediting rates on these older policies cannot be lowered further, this leads to the next issue—rising insurance costs.

3. Rising cost of insurance. Insurance charges are applied not only to recover death claims, but also to recoup

commissions, cover costs related to issuing and administering each policy and to make a profit. To cover their losses in interest margins, the carriers are being forced to raise costs for certain policies.



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That's why five carriers raised their rates in 2015 and why more may follow.

4. People are living longer. Longer life spans used to be a good thing for insurance companies and policyholders. But older policies with higher guaranteed crediting rates are, as we already noted, potentially unprofitable in a low-interest-rate environment. If people live into their 90s, they may also end up having to pay more for their permanent life insurance to maintain coverage.

Insurance companies have always had the right to raise rates on policyholders—at least up to the guaranteed maximum for the policy. But in our experience over the past 28 years, that has *rarely* happened. In fact, the trend was for premium rates to remain unchanged for in-force policies and to go *down* on new policies. But the situation has reversed itself, and it's having a major impact on policyholders.

Here's just one example:

One of our clients, Mary, a 79-year-old policyholder, called in a panic. She'd just received a notification that the premiums on her permanent life policy would have to be nearly *doubled*. Mary happens to be a senior citizen on a fixed income.

"How can they raise my rates when we agreed on what I was buying?" she asked. "I thought I would be paying the same fee for the life of the policy. Now I don't know what to do."

Our mission is to stay abreast of changes in the industry and focus on proactive planning for our clients. Yet we were surprised, too. Which made us wonder: If even we were shaken by a 100% increase in Mary's premium, what was happening to policyholders who don't have trusted advisors to address the problem?

It's important not to view insurance carriers as the "bad guys" in this scenario. Far from acting as profiteers, they are doing all they can to keep rates as low as possible in an effort to protect their own reputations. But they need enough income to fund each policy and maintain enough financial strength to pay out death claims.

In the current environment, raising the cost of insurance is their only option. However, this does not mean that policyholders must just accept the situation and pay up. As with any storm, being proactive can soften the blow.

POLICY REVIEWS

For advisors, such precautions should include an independent policy review.

On the surface, life insurance is pretty basic. You pay a premium for a certain level of coverage and, assuming you continue to pay as scheduled, your beneficiaries receive a benefit when you die. If only it were that simple! When you dig down into the details, life insurance is a highly complex estate-planning tool that requires careful product and carrier selection, in-depth analysis and—perhaps most importantly—periodic review, especially in times of economic and market turbulence.

In today's environment, a careful and independent review of in-force policies is critical to ensure your policy will meet your original projections and provide the coverage your clients expect. An independent review that includes these six steps can pinpoint the most critical policy issues and identify the best possible solutions:

1. Review the policy's crediting rate: Not all changes in cost are as obvious as a hefty increase in your cost-of-insurance (COI) charge. While most product illustrations include a constant crediting rate, even a small change in that rate can significantly impact the actual performance of your policy. For instance, if the rate was originally at 5%, but the policy is now delivering 4%, especially over a prolonged period of time, you can expect a shorter duration of death benefit coverage, higher premiums to maintain coverage or less retirement cash flow. It's also important to note that dividend interest rates for whole life policies are not guaranteed—though many are presented that way. Carriers have the freedom to reduce dividend interest rates and raise charges within the dividend.

2. Review the carrier's financial strength. The rating of an insurance company's financial soundness is often used as a key differentiator when choosing a policy. But the strength of any business can change. Market downturns can damage company earnings, invest-

ment portfolios and capital reserves. Moreover, the ratings are not always easy to interpret. The big three rating agencies, Fitch, Moody's and Standard & Poor's, each have their own ratings systems, making comparing various carrier ratings as troublesome as comparing bonds. That said, it's important to balance the carrier rating with expected policy performance. An analogy is that "Aaa" and "Baa" bond ratings at Moody's both qualify as investment grade, but as long as the bonds do not default, the "Baa" bond will provide over 100 basis points more yield than the "Aaa" bond. The same type of balancing act applies to insurance companies, where you sometimes need to make a trade-off between carrier financial strength and product performance. Also, while life insurance carrier insolvencies are rare, it is always important to review the carrier's financial strength annually to make sure clients get the death benefits they depend on.

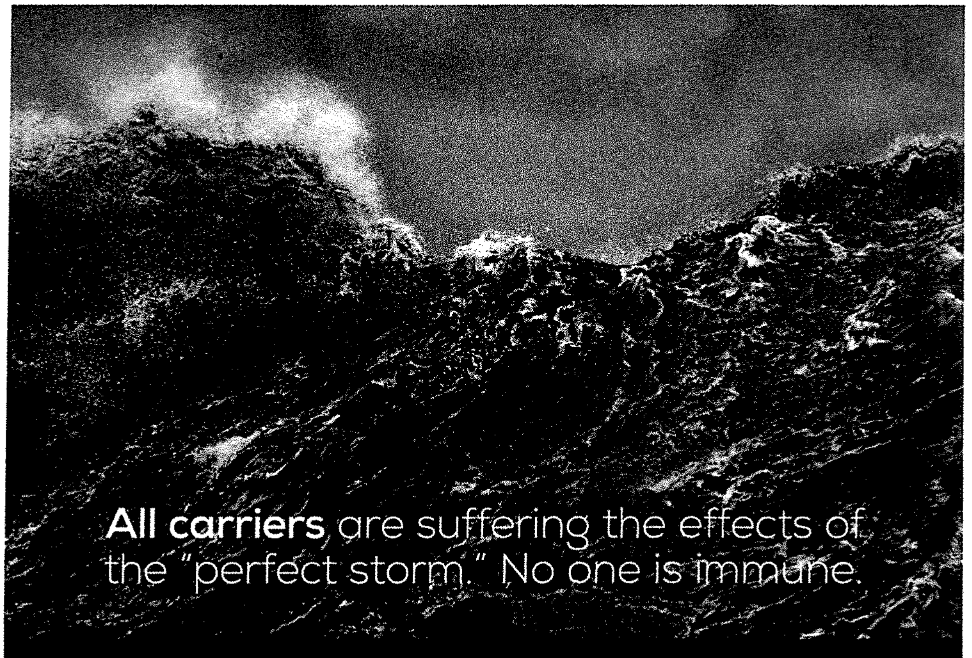
3. Review product charges that impact performance. These charges include a percentage of the premium to cover the costs of issuing and administering the policy and the cost of insurance, primarily to cover death claims. While product charges are subject to guaranteed maximums, it used to be rare for insurance companies to make changes to charges, whether they were increases or decreases. But as we've explained, the low-interest-rate environment means that's no longer the case. Charges can vary by as much as 80% for different products. A careful review will reveal what is being charged for COI, as well as fixed administration expenses (FAEs), cash-value-based "wrap fees" and premium loads.

4. Stress-test policies with downside scenarios. Stress testing is used to analyze the myriad factors that can cause a policy's "illustrated" performance to change. A thorough stress test includes building out illustrations to analyze how lower crediting rates may affect the policy—including the revised cash values by year and at maturity. Stress testing can also help identify strategies for protecting the value of the policy. These may include increasing premiums or reducing the face amount of the policy.

5. Assess the client's ability to fund the policy. The success of any policy is based on the policyholder's ability to pay the premiums. If funding drops below the original calculations, even for a relatively brief period—something that was all too common during the recent financial crisis—the policy performance and coverage period will be negatively impacted. In a worst-case scenario, the policy can lapse completely—a scenario that is more likely than ever in the face of doubled or tripled premiums.

6. Perform a detailed product comparison. Despite the interest rate environment, many competitive life insurance products remain available. Some carriers are particularly skilled at proactively managing portfolio yield distribution—a key factor in successfully managing crediting rates and helping to keep in-force policies intact. Other carriers are adept at offering products specifically tailored for the ultra-affluent. Other attributes to consider are the long-term claims-paying ability of the insurance company and the company's track record in terms of pricing and guaranteed minimum credit ratings.

All carriers are suffering the effects of the "perfect storm." No one is immune. That's why an independent policy review is imperative to ensure your client's policy delivers the expected income and death benefit. Even if interest rates start to rise, it will take time to compensate for the damage that's already been done to carriers' bottom lines. In the wake of this changing economic environment, it is vital to proactively manage your life insurance to maximize policy performance and protect your ability to achieve your client's financial goals. ℛw



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