Financial Planning

CLIENT

Life Insurance Checkup

Review clients' policies annually, paying particular attention to changes in both rates and charges. **By Jeffrey D. Dattolo**

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If you're like most advisors, life insurance planning is an integral component of your wealth management approach for high-net-worth clients. You probably begin the planning process by matching coverage levels to the net worth of the client. But if you end there, you're not only missing an opportunity to truly serve your clients' best interests, you're also failing to fulfill your duties as their fiduciary.

In today's Affordable Care Act era, health care is a hot topic. It's difficult to find a client who doesn't know what their policy covers and what they can expect to receive in return for their payments.

How I Do It

Yet when it comes to life insurance, many policyholders seem oddly content to remain in the dark. Their advisor or insurance broker recommends a policy, the clients review the illustration to understand the basics and expected rate of return and they sign on the dotted line. Most policies then sit in a drawer – or in a trust – and get ignored, other than when it's time to pay the premium, until a death claim is made or a policy cash withdrawal is needed.

As a trusted advisor, you must not make the same mistake. Just as investments should be carefully monitored and adjusted, life policies should be reviewed and analyzed annually to ensure viability. Critical factors in your analysis should be changes in rates and charges.

RATE CHANGES

While most product illustrations include a constant rate of return that is credited back to the policy, even a small change in that rate can significantly impact actual policy performance. If the original illustrated rate was 5% but the policy now credits 4%, the shift could have a substantial effect on the policyholder's illustrated future premiums – causing either a larger premium or greater number of premiums – or retirement cash flow, by reducing distributions.

Additionally, while it's a common misperception that dividend interest rates for whole life policies are guaranteed, they are in fact dependent upon non-guaranteed carrier experience – making it important to monitor policies of all types on a consistent basis.

A few rate issues to watch:

• **Universal life crediting rates:** With general account portfolios primarily backed by investment-grade bonds and mortgages, and interest rates still historically low, carrier crediting ratings are expected to continue to decline over the next few years (subject to guaranteed minimum crediting rates). To mitigate the performance impact on existing policies, it's crucial to review the sustainability of the crediting rate, perform a detailed comparison of competitive products and perform stress testing to evaluate downside scenarios. You may need to recommend increasing premium payments or reducing policy face amounts in order to avoid additional premiums.

• **Whole life dividend interest rates:** These are affected by changing investment experi-

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ence and therefore, like universal life crediting rates, are currently subject to downward pressure as insurance company portfolio yields continue to decline in today's low interest-rate environment.

• **Indexed universal life cap rates and variable universal life earned rates:** These also present complex variables, including growth cap, participation rates and other factors, as well as FINRA's complex regulations. For best results, these policies should be analyzed in detail by a specialist.

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POLICY CHARGES

All life policies are illustrated with non-guaranteed current charge assumptions at the start of coverage, but these charges may change over time. This makes consistent analysis of product charges essential.

• **Universal life product charges:** These could include a percentage of premium, to recoup issue and administration costs, and cost of insurance charges, primarily to recoup death claims. These charges are subject to guaranteed maximums and are rarely changed, although premium load increases and cost of insurance charge increases do occur on occasion.

• **Whole life dividend:** Like many other dividend interest rates, these can be affected by mortality, expense and persistency experience. Because these rates are not calculated consistently among carriers (and should not be thought of as equivalent to a universal life crediting rate), accurate comparisons are difficult. It's possible for better emerging mortality experience to partially offset lower investment earnings, as well as for a dividend investment rate to remain constant even when the underlying charges have increased.

OTHER KEY ISSUES

There are other broader trends that advisors should keep in mind as they go into a policy review.

• **Funding level changes:** Every illustration includes an assumed level of funding from the policyholder, but if actual funding drops below illustrated funding – even for a relatively brief period of time – the effects can include policy lapses as well as changes to policy returns, coverage period or both. In the economic crisis of the past decade, some policyholders may have put funding on the back burner. But in some cases, the impact of a funding decline may warrant a face-amount reduction or a shift to a potentially better-performing product designed for lower funding levels.

• **No-lapse guarantee products:** While these won't see their guarantee impacted by lower-interest crediting rates, even these policies should not be put on cruise control. Late, missed and even early payments – such as payments intended for the next policy anniversary but applied before the anniversary date – may decrease the length of the guarantee. Current universal life products may prove to be better low-cost options with an effective downside performance cushion, cash values for flexibility and upside potential if future interest rates increase.

• **Carrier financial strength:** While life insurance carrier insolvencies are rare, it's still critical to stay on top of any changes in company ratings to guarantee that insurance benefits are paid.

In a market environment that has many people in a state of investment paralysis, continuously monitoring the effectiveness and applicability of your clients' insurance policies should be a primary focus.

The equity market is currently providing opportunities for yield, allowing variable products with flexibility for both equity-based and general account premium allocations. More transparent products that offer potential for in-force performance improvements can help keep the category viable, and proprietary products designed to address the specific needs of ultra-affluent and corporate clients often provide better options.

Also, bear in mind that the Internal Revenue Code offers favorable tax treatment on most exchanges, allowing policyholders to shift from one permanent life policy to another while continuing to defer income taxation on accumulated gains.

The options are out there. It's your job to do your homework, analyze each policy with due diligence and provide the best possible recommendations to help ensure optimal benefits for your clients over the long term. **FP**

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