The Perfect Storm has just blown in for Permanent Life Insurance

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In times like these, what you don't know might hurt you.

Full disclosure: We are financial advisors, and we sell life insurance. Why? We believe in the value and necessity of life insurance for our clients. We've seen the difference it makes when a family loses someone when appropriate life insurance is in place…and when it isn't. That's precisely why we want to shine a spotlight on the "perfect storm" that is happening in the life insurance industry—and what you need to do to be sure this storm doesn't wipe out the safety net that your existing policy is designed to provide.

When the stock market plummets, wise investors take action to be sure their assets are diversified and their losses minimized. Life insurance policies should to be treated with the same careful attention. As a policyholder, now is the time to be proactive and take steps to minimize the impact of this "perfect storm" on the value of your permanent life insurance policy.

Here's what you need to know:

Five insurance companies raised rates in 2015, some by 100% or more.
We've been recommending policies to our clients for years, and this is the first time we've seen this type of shift. No, the insurance providers haven't suddenly gotten greedy. Instead, a perfect and powerful storm has been slowly brewing, and it's now driving unthinkable rate increases for consumers. This storm has multiple contributors, as well as severe implications:

1. **Interest rates have been declining and are 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 the premiums. In a typical environment, as much as 50% of their revenue comes from the income they earn from investments in *interest-bearing securities*, primarily bonds and mortgages, versus what is credited to the policy (i.e., interest margin). Interest margins have been managed by lowering policy crediting rates to reflect lower portfolio yields. However now we face a lethal combination of lower portfolio earnings and ….

2. **Older blocks of policies with higher guaranteed minimum crediting rates.** These older blocks can have guaranteed minimum crediting rates in the 4-5% range, and these rates can't be supported by current portfolio yields of around 5%. Insurance companies price life insurance products with interest margins of 25 to 100+ basis points, and these have been squeezed and, in some cases, gone negative. As crediting rates on these older blocks cannot be lowered further, now insurance companies are ….

3. **Raising the Cost of Insurance (COI).** COI charges are applied not only to recover death claims but also to recoup commissions, cover costs related to issuing and administering each policy, and provide profits. To cover their losses in interest margins, the carriers are being forced to raise the COI for certain policies. That's precisely why five carriers raised their rates in 2015 and more may follow. The carriers' income challenge is further exacerbated by the fact that…

4. **People are living longer.** Before now, longer life spans were actually a good thing for insurance companies and policyholders. Companies were coming out with new products with lower costs, and the trend was expected to continue in light of the medical advancements and more active lifestyles that support longer, healthier lives. The flaw? Older policies with higher guarantee crediting rates are not always aligned in a lower

interest rate environment. Longer life expectancies into the 90s exacerbates the problem for policyholders as they need to maintain coverage longer and pay the potentially resulting higher cost.

This perfect storm can have a significant impact on policy performance.

Insurance companies have always had the right to raise the cost of insurance for 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 today's perfect storm has created an unprecedented situation, and it's having a major impact on the very people life insurance is designed to help. Here's just one example:

> **Mary, 79, called in a panic.**
> She'd just received her premium notice for her permanent life insurance policy. The company notified her that in order to meet the original projection and have the policy last as long as it was designed to, her premiums would be nearly *doubled*. For a senior on a fixed income, the idea of paying twice what she'd budgeted was shocking. Worse yet, she could not understand why it was happening. "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."

Keep in mind that this is our business, and our mission is to stay abreast of changes in the industry and focus on proactive planning for our clients. And 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 a team they trust 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 for serving their customers well. But the fact remains that they must have enough income to fund each policy and maintain financial strength in order to pay out death claims. In the current environment and the added problem of guaranteed minimum crediting rate constraints, raising COIs is the only resource at hand. However, this does not mean that policyholders must just accept the situation and pay up. As in the face of any storm, proactive preparation can provide a huge advantage—and even prevent a negative impact from the situation.

The best tool to battle the storm: 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 your premium as scheduled, your beneficiaries receive a designated benefit at the time of your death. If only it really 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 shifts like the present.

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

1. **Review the policy's crediting rate:** Not all changes in cost are as obvious as a hefty increase in your 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 shown 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* down

the road. It’s also important to note that dividend interest rates for Whole Life policies are not guaranteed (though many are presented as guaranteed), meaning that carriers have the freedom to reduce dividend interest rates as well as raise charges within the dividend. How the environment can impact policy performance depends on the type of policy, premium funding and distributions, and individual characteristics such as age and underwriting. To get a clear picture of what to expect even in these unusual circumstances, your policy should be reviewed carefully.

2. **Review the sustainability of carrier financial strength.** The strength of the rating of an insurance company’s financial soundness is often used as a key differentiator when choosing a policy. Of course, the strength of any business can change over time, and that’s especially true of insurers when they face market downturns that damage their earnings, investment portfolios, and capital reserves. To make matters worse, the ratings are not always easy to interpret, and the grading systems are not standardized among the three agencies (Fitch, Moody's, and Standard & Poor's), which make 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 both qualify as investment grade, but as long as the bonds do not default, the Baa bond will provide over 100 basis points of additional yield versus the Aaa bond. The same may also apply to insurance companies where it can be a slight trade off in carrier financial strength versus superior product performance (i.e., lower cost or higher retirement income). Also, while life insurance carrier insolvencies are rare, it is always important to review the carrier’s financial strength annually to ensure benefits are paid.

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 (increases or decreases). However, historically low interest rates have called for unusual measures as we have seen with the recent COI increases. Charges, even charges that have not been increased, can vary by as much as 80% for different products, and 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. **Complete stress testing to evaluate downside scenarios**. Stress testing is used to analyze the myriad factors that can cause the illustrated performance of your policy to change. A thorough stress test includes building out illustrations in the current environment 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 to help protect the value of the policy. These may include increasing premium levels, or reducing the face amount of the policy if the increased premium is unacceptable.

5. **Assess your ability to fund the policy.** The success of any policy is based on the policyholder’s ability to pay the premiums. If actual funding drops below the original calculations even for a relatively brief period of time (which 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 comparison of competitive products.** Even in today’s environment, many competitive products are still 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. Certain carriers offer more competitive products specifically priced with the superior experience of the ultra-affluent. Other attributes to consider are the long-term claims paying ability of the insurance company (achieved by maintaining high financial strength ratings), insurance company track record of

price improvements in the current environment (e.g., reducing cost of insurance to reflect better emerging mortality experience), and policy maximum charges and guaranteed minimum credit ratings.

Policy reviews are urgent and necessary.

All carriers are suffering the effects of this perfect storm. No one is immune. That's why an independent policy review is imperative to ensure your policy delivers the income or death benefit you expect later on. Even if interest rates begin to trend upward, it will take a significant length of 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 financial goals. An independent policy review is the only way to understand any potential change in policy charges or interest credited, and resulting increase in premium or termination in death benefit coverage—a situation that may have catastrophic consequences to your family, your business, and your beneficiaries who are left with no insurance.

A review may very well reveal that, like Mary, you need to make a change—either because your existing policy will not last as long as you anticipated, or because it won't deliver the cash value you expected. The good news is that a qualified agent can point you toward a more appropriate product that is aligned with both your specific situation and the current economic environment. The Internal Revenue Code offers favorable tax treatment on most exchanges that makes it easier to shift from one policy to another while continuing to defer income taxes on your accumulated gains. There are great solutions out there, and by learning what you don't know, you can head off the impact of the storm and create a much more effective path toward a sound financial future.

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