CONSIDERATIONS OF A POLICY REVIEW

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Situation

Many client's life insurance policy portfolios are a mess. According to LIMRA, more than 60% of U.S. life insurance policy owners don't know what they have or why they purchased it - and that is not good. Unfortunately, after a policy is purchased it often is put in a drawer and not looked at again until a death claim is filed. Trusted financial advisors must help their clients avoid this mistake. Just as investments should be carefully monitored and adjusted, life insurance policies should be reviewed periodically to ensure continued viability. This piece provides a deep dive on the topic to provide some guidance regarding the aspects that should be monitored on a regular basis.

Solution

If you find that your client wants to have their policies reviewed you will want to know what to consider in an analysis. Below are the steps you will want to follow to determine if a client's life insurance portfolio is staying current with his/her current needs and the market.

- Determine the purpose of the coverage and whether the amount owned meets the client's needs based on today's situation.
- Next get a handle on the policy specifics and carrier status.
- Evaluate whether the existing policy(es) and rider(s) meets the client's life insurance needs and compares favorably to what is currently available in the marketplace.
- Review and assess the policy structure to determine if it should be modified to better meet the client's current objectives.
- Identify options to accomplish changes without causing unnecessary taxation.
- Finally, recommend appropriate changes to your client's policy(ies) to better meet their current circumstances.

STEP #1

Determine the purpose of coverage and whether the amount owned meets the client's needs based on today's situation. All life insurance reviews should begin with an understanding of what matters to the client and what they want to accomplish with their life insurance today. So, the place to start is with an understanding of **why** your client purchased the coverage they have. Your client may have a hard time remembering, but don't jump in. Give them time to think. The answer to these questions will tell you a lot about the client and what you need to know to help them further.

- Why did you purchase the particular policy?
- Since you purchased the policy(ies) has anything in your personal or business life changed that might influence what you want to use the policy(ies) for today?

In addition to understanding what the client wants to accomplish, as part of this step you should seek to understand the client's current health and avocation status because a significant negative change can limit options available to the client. Ask the client the following questions:

- Has there been any significant changes in your health status since the purchase of your policy(ies)? Pay particular attention to whether the insured's smoker status has changed or whether a period of time has passed since recovering from a medical impairment because positive health improvements may result in better underwriting rates. In contrast, a negative change in an insured/owner's health tells you the urgency of the review.
- Do you currently participate in an avocation that might be considered dangerous (e.g., aviation, ballooning, auto racing, scuba diving, mountain/rock climbing, skydiving, bungee jumping)? This question is important because participation in some avocations can result in a rating.

Finally, assess whether the amount of the client's coverage is adequate based on client's current situation. There is no shortage of fact finders available to help with this step including those developed by DBS.

Step #2

Get a handle on the policy specifics and carrier status. Once you understand the "why" the next step is to get a handle on the policy(ies) specifics. To do this, the advisor should get the following information:

- Determine the type of policy (term, variable, universal, whole life, combination etc.), the actual death benefit amount, and the riders/options it provides your client/ business (riders such as guaranteed purchase option, long-term care etc.).
- Check the actual policy cash value (if any) and the amount of policy gain and cost basis of the policy.
- Determine if there are any policy loans, type of loan (fixed, variable etc.), the loan interest rate and what it would take to retire the loan.
- Determine premium required to keep the policy inforce. This may be more than what they are currently paying. Inforce ledger illustrations may be needed to make this assessment. Determine policy's MEC (modified endowment) status.
- Uncover possible "no evidence" policy changes that might be available as well as other policy changes available and what, if any, additional premium is needed for adding the benefit.
- If applicable, look into possible conversion or change of a term coverage to permanent coverage and the new premium.
- Just as due diligence must be performed on investment products, it's also important to be vigilant of carrier's ratings. Significant rating down-grades may be a cause for concern.

Step #3

Evaluate whether the existing policy(ies) and its rider(s) meets the client's life insurance needs and compares favorably to what is currently available in the marketplace. When the client purchased the policy it's likely s/he reviewed a policy illustration. Policies are illustrated with assumptions. If the experience is different from the illustrated assumptions, the difference can significantly impact actual policy performance. For example, if the illustrated rate was 6%, but the policy is currently crediting 5.5% that shift could have a substantial effect on future premiums causing either the need for larger premiums or greater number of premiums. In addition, over the past several years there have been several innovations in products and riders. For example, linked-benefit products, those that combine life insurance and long-term care/chronic care benefits, are currently popular with clients and did not exist 10-years ago. Thus, it's important to review policies of all types and their riders to determine if they continue to meet the client's life insurance goals and compare favorably to what is currently available in the market.

Some of the items that can impact a policy's performance include changes in crediting rates and policy charges and missed or changes in premium payments. Following are some of issues that can affect existing policies.

Most product illustrations depict a constant rate of return credited to the policy. Even small changes in the illustrated rate can significantly impact actual policy performance. For example:

- Whole life dividend rates: It's a common misperception that dividends rates for whole life policies are guaranteed, but they are dependent on the non-guaranteed carrier experience. These rates change based on the investment experience of the carrier. Over the past several years the rates have decreased as insurance carrier portfolio yields have declined.
- Universal life crediting rates: Carrier general account portfolios are backed by investment grade corporate and government bonds and mortgages. Over the past several years of low interest rates the crediting rates of universal life policies have declined, some to the point of crediting the guaranteed minimum. To mitigate the performance impact on existing policies, it's critical to perform stress testing to evaluate the downside scenarios. You may need to recommend increasing premium payment or reducing policy face amount to continue a policy viability.
- Indexed universal life cap rates and variable universal life subaccount earned rates: These product present complex variables including cap and participation rates, subaccount yields and other factors. This makes constant review of these products especially critical.

Life insurance policies are also illustrated with current charge assumptions, but these charges can change over time. Insurance carriers can increase charges within a policy, which will alter the illustrated values. For example:

- Whole life dividend charges: Mortality experience, administrative costs and persistency experience are factors that affect nonguaranteed illustrated dividends. It's possible for these charges to increase/change.
- Universal life charges: These can include percentage of premium to recoup issue and administrative charges

and cost of insurance charges to cover death benefit claims and surrender charges. These charges are subject to guaranteed maximum and can increase.

- Indexed and variable life insurance charges: In addition to the types of charges associated with a universal life product, indexed and variable life insurance products will have investment management fees. These fees can change.

Finally, flexible premium no-lapse guaranteed products generate the following additional considerations:

Premium changes on flexible premium products: Every illustration assumes a payment level and length. If actual payment level or timing of payment differs from the illustrated amount, even for a short period, the effect can include change in policy return and lapse.

No-lapse guaranteed products: While lower crediting rates will not impact the guarantees as long as premium payments amount and timing are maintained, late or early payment can decrease the length of the guarantee.

Step #4

Review and assess the policy structure to determine if it needs to be modified to better meet client's current objectives. In addition to reviewing the product and carrier it's critical that the policy owner/beneficiary structure meet the current needs of the client. Over time a client's family and financial situation can change. Furthermore, tax and legislative changes can impact how a policy is structured. Some of the information you should gather in this step include the following:

- Verify the current policy owner and beneficiary structure.
- Determine what, if any, changes have been made to the policy owner or beneficiary structure since purchasing the policy. Changes can result in inadvertent tax consequences.
- Gather supporting documents, if any, that back the intended use of the policy (i.e. 101(j) notice and consent document, buy-sell agreement, trust document, split-dollar, deferred compensation agreement etc.)

In addition to the above information, the following questions will give the advisor an indication of how to structure the policy ownership and beneficiary(ies) designations.

- Are the beneficiaries under the policy(ies) still what you want? This question could uncover a change in marital status.
- Has there been changes in your immediate family such as birth, adoption or death of a family member? This might identify an inadvertent oversight of beneficiaries.
- Since the purchase of the policy(ies) has there been a change in your financial or employment situation since? If the insured has started a business since purchasing the policy(ies) there may be other needs for insurance or additional ways to structure the policy(ies). Likewise, significant increase or decrease in net worth or income can be factors to consider in structuring policy(ies).
- Has there been a change in a beneficiary's ability to manage their finances? A change in a beneficiary's mental ability can signal a need to modify beneficiary designations.

Step #5 & #6

Identify options to accomplish changes without causing unnecessary taxation and recommend appropriate changes to your client's policy(ies) to better meet their current circumstances.

Once all the appropriate information has been gathered in the prior steps the last steps involve identifying options and then making recommendations to the client. It's been said that individuals don't like to be sold but they like to purchase. The point being most individuals like to know options, but want your insight and suggestions.

In Summary. There are many factors to consider that may impact the performance of a life insurance policy. It's important to conduct regular policy reviews to help ensure that client's long-term planning and product objectives are satisfied.