Disruption in the Life Insurance Industry

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By Mark Leyden, CLU

The Storm

A Perfect Storm has landed in the financial service industry and will have a detrimental impact on policyholders. The impact will be long term and largely unnoticed by the financial press. The persistent low interest rate environment is devastating life insurance policies purchased over the past 25 years. Cash value polices, sometimes referred to as permanent insurance, have an interest/investment component applied to the cash value build up within the policy. Interest rates are at historic lows and remain low for an extended period. The result is lower crediting rates being applied to the policy cash value. It is not uncommon to see a policy written in the 1980's with a projected rate of 8% having received a 3% or 4% crediting rate for the past five years and for the foreseeable future. This has a direct impact on the premium funding required to maintain the policy in force to age 95 or 100. In one recent case the policy was originally funded at $15,000.00 a year for $1,000,000 death benefit. The premium required now to maintain the death benefit to age 100 is $34,000.00.

From Bad to Worse

Low interest rates are also impacting the profitability of the life insurance companies. Traditionally the industry invested in bonds and mortgages. As the yield on bonds has remained low, companies have taken two tacks. Some companies have varied from the traditional bonds and mortgages by adding alternative investments such as commodities and private investments. In addition over the past 18 months, several major life insurance carriers have elected to increase the internal Cost of Insurance or "COIs" on in force policies. At last count, the number of major life insurance companies that have increased COIs was 13. This occurs on all policies in a specific class, not by individual insured.

The companies have always had the legal contractual right to increase Cost of Insurance charges. Historically, it has not been a practice of the industry. This had captured the attention of some state regulators, as reported in the *Wall Street Journal* article, Friday, November 18, 2016. "Life Insurers Face Heat in New York." According to the WSJ article, tens of thousands of policyholders have been hit with higher charges in their polices, ranging from single digit percentages to more than 200%. The article indicates Insurers' portfolios are yielding 5%, down from 10% in the middle 1980's.

In the recent book, *The Life Insurance Policy Crisis*, authors E. Randolph Whitelaw and Henry Montag state, "It is estimated that approximately 25% of in force flexible premium TOLI (Trust Owned Life Insurance) are projected to lapse during the insured's lifetime." They provide that based on 2008 data, 1.1 million policies lapsed with a face value of $112 Billion. In 2013, according to an article, by Martin Shenkmen, CPA, JD, AEP, the lapse rate was 5.7 percent; 82 percent of these lapses generated no value to the policyholder.

69%	of all policies have not been reviewed in the past five years
20%	of all those policies are likely to lapse in the next three to seven years
40%	of all in force non-guaranteed TOLI policies will lapse during the insured's lifetime
12%	of the in force guaranteed TOLI policies have compromised guarantee features
90%	of ILIT policies are managed by nonprofessionals...Many of these are time bombs waiting to explode

Source: Markham Whitelaw, William Reis, "Managing Trust Owned Life Insurance Revisited," Trust and Estates, April 1, 1999

Life Insurance Asset Management

Ninety percent of insurance trusts are managed by trustees that have no particular background or skill in managing life insurance assets, according to Mr. Shenkman. The proper management of policy assets requires a process that encompasses the insured, the policy performance, the insurer, and the market place. A good process would include the following items:

1.) Detailed review of annual policy and the future projection policy values through an in force ledger of values provided by the life insurance company – special attention to the year of policy lapse.

2.) A comparison of #1 to the original policy illustration that was the basis for policy purchase.

3.) A discussion of insured's health and financial position as well as that of the owner. Additionally confirmation of the purpose for the insurance and objective of the policy owner should be documented.

4.) A life expectancy table review.

5.) A review of the insurance company financials and ratings.

6.) Recommendations for remediation should be received and documented to the file. Remediations might include the following actions:

- Increase premium funding
- Reduce policy death benefit
- Consider market place for competing price and new coverage subject to evidence of insurability
- Consider potential for a life settlement (sale of policy) in the secondary market

Buy and Hold is No Longer the Strategy

As if the above discussion was not enough to challenge policy owners, it will become increasingly difficult to find qualified experts willing and able to assist in this process. It is important to retain the services of an independent credentialed professional specializing in the management of life insurance assets.

Most financial advisors sell policies on occasion upon request of a client. Many advisors can recognize the need for insurance but lack the experience and training to navigate the landscape of products and companies. Many life agents are representing one primary company. In the more sophisticated financial strategies, no one company can address all the possible client objectives. The life insurance industry is facing a crisis of attrition. Most professionals entering financial services over the past twenty years gravitated to investment assets under management or are entering their own retirement, leaving few with appropriate experience.

A Powerful Financial Asset That Must Be Managed

Life insurance is unequalled in its ability to provide tax efficient capital at the time it is most needed. The products have become increasingly complex. Complicating the management of policies are the devastating impact of persistent low interest rates and, in some cases, the increasing cost of insurance charged inside of existing policies. The proper policy management adheres to a documented process of policy asset review – the advisors, owners, and trustee should work with qualified credentialed independent experts.

The days of buying policies and stuffing them into a drawer are over. Be proactive and manage these significant financial assets while there is time.

About the Author

Mark Leyden, CLU, is a 30-year industry leader. He is an independent advisor serving the business owner and their advisor. He is a member of the Society of Financial Service Professionals and the Forum 400.