

FAQs ADAPT TO CHANGING CIRCUMSTANCES IN THE CURRENT INTEREST RATE ENVIRONMENT

Our previous two FAQs focused on current planning opportunities created by the interest rate and market environment. In this piece, we will turn our attention to why this same environment makes it crucial for clients to have their life insurance policies reviewed.

THE CURRENT INTEREST RATE ENVIRONMENT

How does the low interest rate environment affect life insurance companies?

Over the last 4 decades, we have seen bond yields trend significantly lower. Bonds are the cornerstone of an insurance company's general account investments and the life insurance companies are not immune from the impact of lower yields.

Lower bond yields for the life insurance companies generally lead to reductions in whole life dividends and universal life crediting rates. And unfortunately, given the Fed's recent actions, it appears that low bond yields are here to stay for longer than previously expected.

A PROPER REVIEW CAN OFTEN UNCOVER OPPORTUNITIES

What are the risks of not reviewing my policies based on what is happening today?

Many insurance advisors fail to provide their client with periodic reviews. Like other financial assets, real world events may impact life insurance performance both negatively and positively.

The cornerstone of a life insurance advisory practice should be a management process which regularly monitors product performance and responds to changing client circumstances.

The policy management and review process should also monitor for opportunities that are consistent with a client's objectives. Just as an investment manager might rebalance a portfolio, a review should look for instances where existing policies can be made more efficient.

Proper reviews will also highlight current market conditions and make recommendations which reflect the risks and rewards of alternative or additional bespoke strategies.

THE BENEFIT OF INSURED EQUITY INVESTMENT STRATEGIES

Are all life insurance contracts affected in the same manner by the low yield environment?

The short answer is ... no. Policies which provide the opportunity to invest in either registered and non-registered securities (or both) are generally not subject to the bond portfolio yields of the insurance company.

Many of our clients use these policies as a tax advantaged asset structure for some of their investments. Within a life insurance contract, cash value accumulates without tax, funds can be reallocated tax-free, and the policy value can be accessed without a taxable event. Additionally, all of the gains will be passed to the beneficiary income tax-free.

Like all financial instruments, life insurance is impacted by economic events. But these events often present opportunities. Without a proper review, a client cannot understand the value of what they own or be assured that their objectives are being met.

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WHOLE LIFE DIVIDENDS AND CASH VALUE OPPORTUNITIES

I implemented a whole life policy in 2005. Do I need to have the policy reviewed?

JR KATZ defines life insurance performance risk as the potential variance of actual results from projected performance. In this instance, the 2005 projected future dividend assumed a rate that is 50% higher than the actual 2019 dividend.

The low yield environment is making it very difficult for the whole life companies to maintain their current dividend rates. Most observers acknowledge that there will be dividend reductions across the industry in the fall.

Some clients may believe that now is an opportune time to implement an interest rate sensitive asset because we are “on interest rate lows.” Others may want to reduce their interest rate exposure in their life insurance portfolios by either transferring the interest rate risk to the insurance company or by moving funds into equity based investment policies.

A proper review will provide a contemporary analysis, place the policy in context with your current planning needs, as well as propose alternative uses for the cash value.

UNIVERSAL LIFE CREDITING RATES AND POLICY MANAGEMENT

My parents bought a traditional universal life policy on my father’s life in 1990. He believes that the policy was designed to stay in force for his lifetime regardless of his age at death. What should I tell him?

It is important to remember that in 1990, a \$1M, long duration municipal bond portfolio would have produced about \$70K of annual income. Today, that same \$1M would generate about \$20k of annual income. Like municipal bonds, the yield story has also impacted traditional universal life policies.

When a traditional universal life policy is modeled, prevailing crediting rates generally form the baseline to determine the appropriate premium payment. A client will choose a premium payment for a certain death benefit based on an assumed crediting rate.

If the assumed crediting rate is lower than future crediting rates, there will be more cash value than projected to support the death benefit and less premium payments may be required in the future. If the crediting assumption is greater than future crediting rates, there will be less cash value than projected to support the death benefit and premium payments may have to be increased in the future.

A proper periodic review will help the client manage these crediting rate changes and will propose potential improvements within the contract.

POLICIES CAN HAVE VALUE EVEN AS OBJECTIVES AND NEEDS CHANGE

My mother had her universal life policy reviewed. Her circumstances have changed and she no longer needs the death benefit protection. What can we do?

If her planning no longer requires maintaining the policy, one option is exploring the life settlement market. This highly regulated secondary market provides a policyholder with the opportunity to monetize their policy during their lifetime. Changing circumstances often means identifying new solutions to better optimize planning.

Clients that are 70 and older or younger clients with underlying health impairments may be viewed as favorable insureds in this market.

The majority of policies sold are universal life contracts. Whole life contracts are generally not attractive to the buyers. In addition, term insurance policies with conversion rights may be viable. Rather than simply letting these policies lapse, the client should consider their options in the secondary market. An asset the client believed was worthless can prove to be quite valuable.