LIFE INSURANCE POLICY REVIEWS
OFTEN UNCOVER SIGNIFICANT SAVINGS

Life insurance is a unique financial product with several tax advantages over other financial products. The flexibility and liquidity provided make life insurance an asset of choice for many applications including income protection, retirement planning, business succession planning, and estate planning.

However, the life insurance industry has changed dramatically over the last decade. Products are now more complex, competitive, and creative, many life insurance companies have become divisions of large financial service conglomerates, and buyers have become more educated and sophisticated.

Unfortunately, many policies purchased in the last ten years will not perform as expected. Lower than expected interest rates and investment returns have made many policies vulnerable. At the same time, the life insurance marketplace has grown much more competitive in regards to product design, underwriting advances, and pricing. In fact, a recent Trusts and Estates article reported a 1998 study that showed in 75% of trust owned policies that were at least five years old, the death benefit could be increased by 40% without any increase in premium.

There are a number of valid reasons why a new policy should be obtained in exchange for another policy, including reduced costs, increased benefits, or improved policy guarantees.

Improvements in mortality experience and competition among insurance companies

As people live longer, insurance companies have experienced reduced mortality costs. As a result, the cost of insurance has actually declined in recent years. This is especially true for term insurance. While most insurance companies adjust their pricing for new policies to remain price competitive, very few insurance companies adjust the pricing on existing policies to reflect the lower cost of insurance.

The companies that do not make pricing adjustments on older policies are hoping that those policy owners do not compare the performance of their existing policy to a more competitively priced policy. Therefore, it is very important for policy owners to periodically review the performance of their insurance portfolio. In many cases, when an insured is healthy and can still obtain favorable underwriting, significant improvements can be made in policy performance – either in lower premiums, more death benefit, and/or greater guarantees.

Mergers, acquisitions, and changing financial strength of insurance companies

The promises of a life insurance company are only as good as its financial strength and claims paying ability. Many factors in today's economic and business environment place pressure on all insurance companies. Well-managed companies with deep financial resources can remain profitable and competitive through inevitable economic cycles.

It is often the case that many life insurance policyholders own policies issued by companies that no longer exist. Like many other industries, life insurance companies are often purchased by larger companies. The company a person bought life insurance from may be a very different company today. Therefore, it is important to periodically review insurance policies to make certain the policy is backed up by a financially sound insurance company dedicated to servicing all of its insurance policies.

Financial performance of insurance company investments and its impact on policy performance

Today's interest rate environment has placed downward pressure on all insurance companies' general account investments that support its traditional cash value life insurance products. An insurance company's general account investment allocation is conservative and highly regulated. Generally, a large portion of an insurance company's general account is made up of investment grade bonds. Other investments will include real estate, mortgages, and both private and public equities.

Some insurance companies have consistently better investment performance than others. Additionally, some insurance companies pass a larger portion of the investment earnings to their policy owners than other companies as well.

Policy Service provided by the insurance company and the selling agent

As insurance companies merge and consolidate, the ability to provide a high level of consistent service and information often diminishes due to incompatible information systems and increased costs. Additionally, the number one complaint of policy owners is poor service from the selling agent. The traditional compensation structure of most agents provides little financial incentive to provide ongoing service after the initial sale. Therefore, it is very important to work with an insurance advisor with an ongoing commitment to policyholder service.

Changing legal and regulatory environment

There is probably no other sector in today's economy that must adjust to changing IRS rules and regulations as the finance sector. Since insurance is often purchased as part of an overall estate or financial plan it is critical that the plan is reviewed periodically to ensure that the insurance and the estate or financial plan meets the client's objectives.

New products and features

Life insurance products have evolved and improved dramatically in recent years. Some of the more important features that are now available include:

- "no-lapse" guarantees that offer guaranteed life insurance coverage at a much lower cost than traditional whole life products,

- term blends that reduce the acquisition costs of permanent life insurance and enhance long term policy performance, and
- extended maturity riders that will keep tax-free life insurance coverage inforce if the insured lives beyond age 95 or 100

Depending on the purpose of the insurance and the objectives of the client, these features may greatly enhance or lower the cost of planning that includes insurance.

Fiduciary's obligation to review performance and appropriateness of trust owned assets

Trustees are required to exercise prudent fiduciary responsibility in regards to the investments and assets owned by the trust, and this would include life insurance. There are always new developments affecting the policy's performance, the availability of new products, as well as changes in the law. The vast majority of life insurance trusts are not being properly administered, and as fiduciaries, the trustees are potentially liable. Even if there is no legal action, beneficiaries may be harmed if issues regarding life insurance performance or structure are not identified and corrected, if necessary. This was deemed to be important enough that the Office of the Comptroller of the Currency mandated (12 CFR 9.6) that national banks have written documentation of the insurance in a trust and an annual review of a trust's assets.

Conclusion

If the replacement of an existing life insurance policy is being considered, there are some potential disadvantages that should also be considered:

- The new policy may require a new 2-year incontestability clause
- If there are loans against the policy, the transfer of policy values may have potential tax consequences.
- If the replacement does not occur as a Section 1035 tax-free exchange, any gain in the old policy could be taxable as ordinary income.
- New life insurance policies contain new sales and acquisition costs and a new surrender period. However, using a properly designed new policy often mitigates these costs.

The replacement of one policy with another is a financial transaction that should be entered into only after serious consideration. However, in many circumstances, policy owners can significantly improve the benefits or reduce the costs of owning life insurance.