August 2016 Financial Planning Bulletin

Life Insurance – Will Your Policy Pay at Death?

With life insurance policies, there is much more involved than meets the eye. I have heard the following quotes dozens of times over the course of my career…

"I have paid my policy premium on time every year, so my policy should be okay."
"I stopped paying premiums years ago but my cash value keeps growing so I feel good about it."
"My agent told me that I only needed to pay for seven years, then the dividends will take over."
"I had another agent look at my policy a few years back and they thought it was fine."

Unfortunately, I have also sat through many policy reviews where the statements above did NOT hold true. With permanent insurance, things are not always okay unless current in-force illustrations (also called ledgers) prove that your policy still remains viable to your target mortality age. Term life policies are indeed quite simple – pay your premiums timely for the stated duration and hope your heirs never need to cash in the policy! (Note: less than 2% of term life policies pay a death benefit due to expired or lapsed policies prior to death.) On the other hand, any permanent policy with a cash value element (includes whole life, universal life, variable universal life and index universal life) requires ongoing monitoring for the following reasons.

Your initial premium amount was calculated based on these key factors; 1) credit interest rate / performance 2) internal policy expenses 3) administration costs 4) timing of premium payments 5) loan rates – if applicable.

The top culprit for most permanent policies being in poor financial condition today is actual returns coming in much lower than assumed interest rates/market returns on cash value. **U.S. interest rates hit an all-time low** on July 8, 2016 as measured by the 10 Year Treasury Note of 1.32% and 30 Year Treasury Bond of 2.09%. The majority (if not exclusive) of a life insurance company's general account is invested strictly in government bonds. Thus, when insurance companies have a minimum guaranteed credit interest rate of 3% (many companies have petitioned state insurance commissioners to reduce this floor) yet their ROI is less than 2%, they have been forced to **lower actual interest credited from the original assumed rate** (depending on year issued, often 4.0% - 4.5%). For policies tied to underlying stock market performance (variable universal life "VUL" and index universal life "IUL") the news doesn't get any better. The **S&P 500 index has only increased in net asset value by 2%** annualized for the 16 year period from 2000 to 2015. If your policies were purchased in the late 1990's or early 2000's, the assumed returns were likely **three to four times higher than actual returns**.

Based on this actual return divergence, premiums MUST go up to balance the mathematics behind the original premium scale. Unfortunately, insurance companies and/or agents usually do not contact the policy holder to point out this "bad news." Instead, they assume you notice this information from the annual policy statement fine print that is required to be mailed every policy anniversary date. For many clients, the only clear notice or alert they receive from the company is a **60-day notice that their policy will lapse** without additional funds added.

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Traditional whole life insurance may be the only category of policy structure that could still be in good financial condition, primarily based on the higher premium structure that incorporates premium payments and savings. The one issue with these policies could be the accumulated "paid up" additions may not be as high as initially projected based on a lower divided scale. So your base death benefit would still be protected, but the projected "accumulated dividends" would likely be lower than originally illustrated.

Life insurance serves as a much needed risk management tool for families and should be an integral part of every financial plan. Life insurance policies are also very tax-efficient and can be an effective tool for **transferring wealth to the next generation on an income tax-free basis**. However, we want to ensure that Frontier clients recognize the value within any existing policies and receive frequent analysis of policies to capture the maximum financial benefit either to the policy holder (cash value) or their beneficiaries (death benefit). Our team of professionals are here to provide assistance in managing these valuable assets.

Specific action items required

1) Revisit the reasons you purchased each policy and consider how your needs may have changed.
2) Work with Frontier to determine suitability of policy amount, type, duration, and beneficiary.
3) For term policies, request a quote comparison as insurance costs have declined with mortality trends.
4) For permanent policies, request an in-force illustration from your carrier stipulating current interest rates and policy charges rather than original assumptions.

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