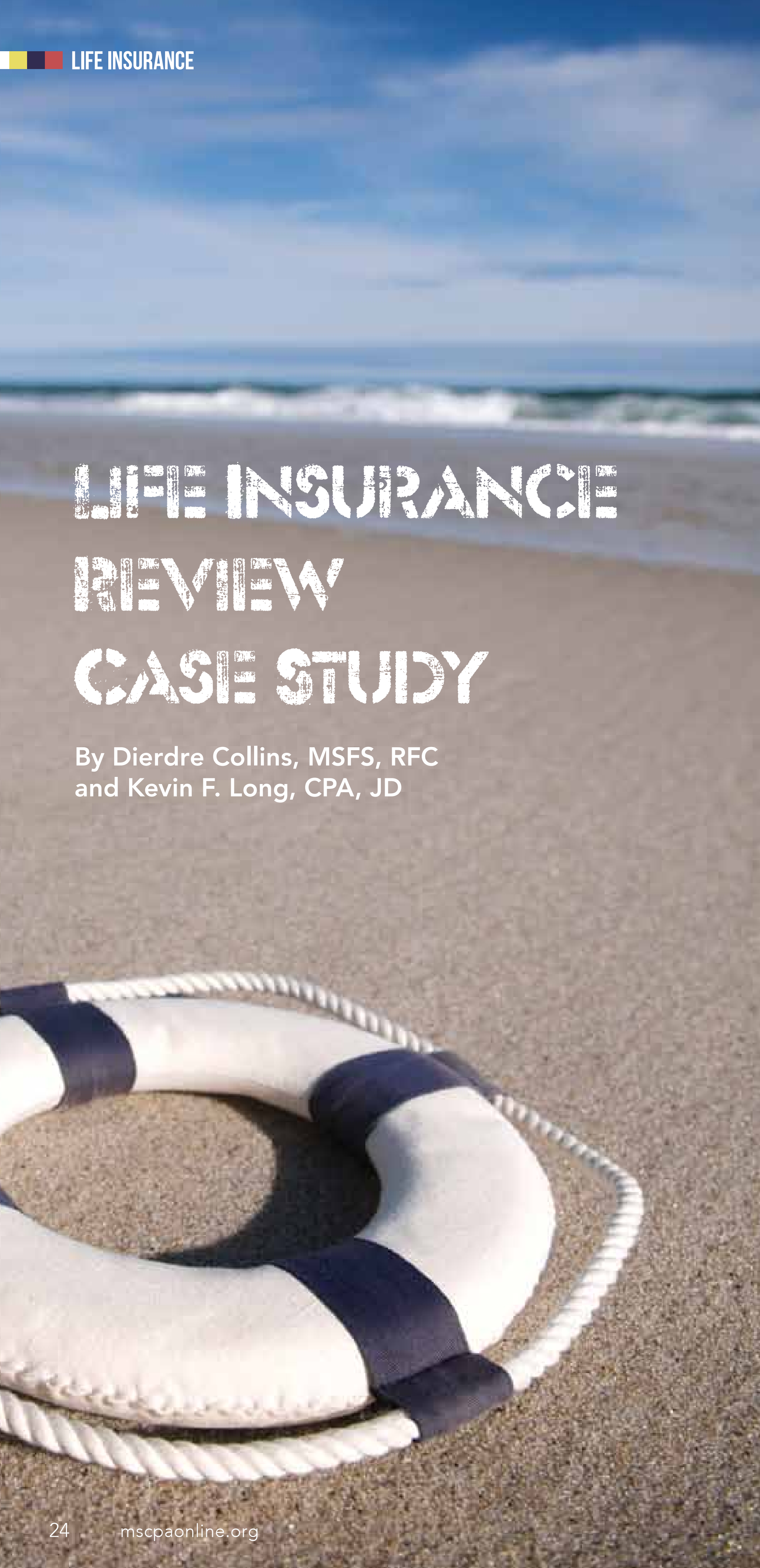

LIFE INSURANCE REVIEW CASE STUDY

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Do you or your clients have life insurance that is underperforming? Policies that are not efficient for current needs? Do you own older products that are no longer cost-efficient? Own policies that are scheduled for a jump in premium? Are you unaware of new products and riders that may offer better options? The fact is, new and better products exist and they are less expensive.

An insurance policy review is both a process and a tool which should be employed at regular intervals to ensure that each individual's specific needs are being met — and that they are getting real value for their premium dollars. Insurance products are constantly changing to reflect consumer demand and economic reality, and like any other financial instrument, they should be reviewed on a regular basis. Changes in the life insurance industry have led to new, more efficient policies that were developed in response to a more competitive environment brought on by mergers and demutualization. In addition, interest rates and market volatility can significantly affect the underlying cash value in a permanent life insurance policy.

A life insurance review evaluates your existing life insurance coverage. By analyzing information on the performance of your current policies, and reviewing your options for optimizing the benefit and cost effectiveness of your coverage, you are helping ensure that your current and future objectives are being met at the lowest possible cost.

Essential questions that factor into the review process include:

- Is your life insurance on track to meet your intended goals?
- How is your policy performing relative to its original objective?
- Are your insurance contracts among the most competitive and cost-effective on the market today?
- Has your financial or family status changed?
- What is effect of changes in interest rates and increases in the cost of insurance?
- Have the needs that prompted the purchase of your existing life insurance policy changed?

Documents and information that factor into the analysis include:

- A policy summary;

- The structure of the policy such as ownership, beneficiaries, and payment methods;
- The underwriting rate class and potential improvements;
- The effect of changes in interest rates and increases in the cost of insurance; and
- The financial stability of the insurance company.

Fiduciary Duties for Trust-Owned Life Insurance

A trustee has a fiduciary duty to invest and manage trust assets in a prudent manner. This includes not just traditional investment assets, but other frequently overlooked assets such as life insurance.

The Uniform Prudent Investor Act (UPIA), which most states have adopted a version of, provides that:

> "[A] trustee who invests and manages trust assets owes a duty to the beneficiaries of the trust to comply with the prudent investor rule… a trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution."

Trustees, who breach this duty, may be liable for monetary damages to the trust beneficiaries.

A key responsibility of the trustee is to have a disciplined investment process that seeks the greatest return for the least amount of risk. In order to help maximize potential trustee liability with respect to trust-owned life insurance, it is advisable to develop an investment policy statement (IPS) for the purpose of documenting this process. At a minimum, the IPS should cover the following:

- Premium level to be adhered to, based on grantor's gifting limitations;
- Type of coverage to be held by the trust, based on the designated risk tolerance;
- The purpose for the coverage; and
- Duties and responsibilities of the trustee with respect to trust-owned life insurance.

In addition, the key component of an IPS is a commitment to regularly review each policy owned by the trust. Chances are, many things have changed over the years since the life insurance was purchased. It is the responsibility of the trustee to ensure the life insurance is performing as expected, and is providing the best possible benefit at the lowest cost for the trust beneficiaries. Reasons to have the life insurance reviewed regularly include:

- Policies may not be performing as projected, due to market downturns over the past few years or historically low interest rates;
- Policies may be at risk of lapsing, leaving the trust beneficiaries with nothing and the trustee with a major potential liability for failing to properly monitor the policies;
- Grantors may have to make larger premium gifts than anticipated to keep the policies in-force, and could exceed their annual exclusions;
- Grantors may have to make premium gifts for a longer period than expected (What if the premiums are dependent on gift-splitting and one spouse is not likely to live through an extended premium-paying period?);
- Newer products have been developed that might be more cost-efficient or offer better guarantees or both;
- It may be possible to pay less premium for the same coverage or obtain more coverage for the same premium;
- Guaranteed death benefit universal life, which is a relatively new type of life insurance product in the marketplace, can often provide the same guaranteed death benefit as whole life at a much lower cost;
- Underwriting changes may have occurred;
- What was once considered high-risk for underwriting purposes might be standard today and cost less;
- Improved health or lifestyle changes may have occurred, providing the potential for better underwriting offers and lower premiums;
- The amount of life insurance needed might have changed and current coverage could be insufficient; and
- Changes in insurer financial ratings could put the policy at risk because the company backing it is at risk.

Continued on page 26

CASE STUDY

John and Jane Doe asked to have their existing life insurance inventory reviewed at ages 79 and 76 respectively. John had three universal life policies as well as two whole life policies that had been in force for years. The combined death benefit totaled $3,000,000 and John had arbitrarily stopped making premium payments years ago. Jane had one universal policy with a $250,000 death benefit. They questioned the need for the insurance and wanted to see how the policies were performing. They both signed limited powers of attorney so that the necessary in-force ledgers could be obtained from the insurers.

Simultaneously, they supplied their financial information, and after reviewing a comprehensive financial plan that was generated for them, they decided that the need for the existing death benefit was not necessary given the size of their estate and investable assets. They clearly had sufficiency of retirement income to age 100. As pleased as they were to discover that, they also became aware that their projected estate tax liability was $6,000,000. They had six children and were very concerned about providing them with liquidity upon the second death to defend against the eroding effect of estate taxes.

As it turned out, all policies were not performing as expected. The older policies were sold to them using assumptions that, while reasonable for the economic climate years ago, are unrealistically high in today's environment. The participating whole life policy was at risk to fail because of dividend cuts over the last several years. The universal life policies were being credited at a rate that was 550 basis points lower than the illustration on which the policy was sold. For those policies to stay in place to age 100, $135,000 of annual premium would be required at their current ages.

Given the large cash value in the policies and the fact that all universal policies were scheduled to implode in a few short years, John and Jane submitted to an informal underwriting process and realized that there were no major health issues that would normally affect medical underwriting. They surrendered their existing policies after purchasing a $6,000,000 guaranteed universal second-to-die policy in an irrevocable life insurance trust, after carefully selecting a trustee that would comply with a well-drafted investment policy statement.

By using the lump sum contribution of the cash value, the scheduled premium for the new survivorship policy was reduced to $15,000 annually. They were actually able to double their life insurance coverage and reduce the annual premiums by $120,000 using the cash value from the cancelled policies before the pending expiration of the most favorable estate and gifting environment.

A Policy Review is Not a Replacement Program

Instead, it is part of an ongoing assessment of your or your clients individually or trust-owned life insurance. We can help you to analyze existing life insurance to determine if it is appropriate for the needs of the beneficiaries, and whether the type and performance of the life insurance are aligned with the trust's goals. We have the resources to help you to:

- Examine the individual's or trust's current coverage and offer unbiased comments in up to 18 different areas;
- Examine ownership and beneficiary designation;
- Provide you with a sample investment policy statement;
- Compare the current coverage to the individual(s) or trust's anticipated needs; and
- Compare the current coverage to a newer, alternative policy.

For more information please call Harbor Strategies Group at 781.229.2300.

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