Tale of Two Policies

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How much does your actual policy look like the sales illustration?

A friend of mine who is single recounted how social media posts of people on dating sites seldom match the actual person. It struck me that the same is true when it comes to life insurance illustrations matching actual policy performance. Too much time is spent on comparing illustrations instead of asking how has a product like this done over the last 15 years?

Thirty-eight years of experience in working with and for insurance professionals has convinced me that there is a 10X difference between the sale of a thoughtfully designed insurance policy coupled with ongoing monitoring and administration (i.e., service and advice), as compared to the sale of a poorly designed product with no ongoing monitoring and administration. While monitoring and ongoing administration is not a regulatory requirement, I firmly believe that it significantly impacts policy performance and, ultimately, client experience and should play a huge part in the value chain when compared to an agent that meets absolute minimum regulatory standards and disappears after the sale.

Our firm manages and advises on over $10 billion of investments through an SEC-registered RIA with and through our member firms. We also annually recommend thousands of financial products to clients through our FINRA-registered broker-dealer. From my experience, I believe life insurance is the most complex financial product we work with. After almost ten years of monitoring thousands of life policies through Valmark's Policy Management Company, we have seen ongoing monitoring of policies and administration having a significant impact on whether a policy performs as anticipated at the initial time of sale. The "advisor alpha "makes all the difference. To illustrate this point, I would like to share the performance of two policies, both sold more than ten years ago.

The life insurance industry almost exclusively measures success by the number of new policies sold, however, the true measure of success should be viewed from a client's perspective. More precisely, this means having policies that provide what was initially promised and fulfill their intended purpose. Ultimately, this is accomplished by delivering advice and ongoing administration around a quality product in a way that meets or exceeds the client's expectations and achieves the client's intended goals.

Case Studies

The Policy. The first case involves a 44-year-old client who had exchanged a whole life product for a Zurich IUL policy in 2013 to "increase their death benefit with no more money out of pocket," according to the sales illustration. The client was promised that $1,224,029 of cash value from her surrendered Northwestern Mutual policy would produce $12,598,361 of death benefit with the new Zurich policy. The current caps and projections at the time of sale showed that the $12.5M of the death benefit would grow to $28.5M of death benefit at the client's life expectancy. The policy was projected beyond age 100 with the illustration showing $71M of cash value and a slightly higher death benefit at age 100.

The Performance. The client is now age 55. The agent who sold the policy has disappeared and the client's trustee has requested illustrations in 2015, 2017 and this year. The cap rate has fallen from 10% at issue to 6.5% today. In 2015, two years after the policy had been issued, the projected death benefit at life expectancy had fallen to $15.6M. The policy was projected to remain in force. In 2017, the cash value could only support the original death benefit to age 102 and the latest illustration today shows a lapse at age 86.

Clearly, the policy is failing, and the potential solutions are painful; pay $208,719 for ten years ($2,087,190 total) to keep the $12.5M of death benefit or cut the insurance amount nearly in half to $6.3M with no more projected premium. Based on these new assumptions the client will get 1/4th of what they were promised at life expectancy with this IUL policy.

The Policy. This second policy is one that has been in Valmark's Policy Management Company almost since its inception; it is a Lincoln VUL policy with guaranteed premiums. The original death benefit was $3,000,000 on a male age 76 with guaranteed premiums of $149,500 due all years to age 100. The guarantees produced $3M of death benefit to age 117. Illustrations were run at 8% and the projected cash value at year 12 was $1,286,000. Because of the premium and death benefit guarantees, it made sense to allocate the cash value 100% to equities.

The Performance. Strong equity performance has produced over $2M of cash value, which extended the guarantees to 126 and perhaps, more importantly, if cash values continue to grow at 8% trigger a guaranteed paid-up policy option at age 90, a full 10 years ahead of projections. The death benefit cannot go below the original $3M guarantee but could grow above the $3M with continued good market performance.

Lessons:

- **Contractual Terms:** The VUL had substantial guarantees that the IUL policy did not. Those guarantees in the VUL allowed for aggressive investment of cash values, which has the policy on track to provide fewer premiums and a rising death benefit. The contractual term in the IUL, which was likely not understood by the client at the time of sale, was the ability for the insurance company to unilaterally drop the cap from the initial 10.5% at issue to 6.5% today. This has resulted in a death benefit that needs to be dropped to account for the much lower policy values.
- **Reasonable Assumptions:** The underlying crediting rate of the inforce IUL policy drastically underperformed and the VUL overperformed. The assumptions in the first case were aggressive and were, as far as I can tell, unquestioned by the agent. Many of my previous posts have cited work by Bobby Samuelson and Mark Whitelaw that IUL is not inherently bad but if it is an option, experience shows no more than a 4.5% to 5% interest rate should be used.
- **Ongoing Monitoring and Management (With Written Reports):** Agents often talk about policies that are crashing. Seldom does a policy crash suddenly. They

gradually drift off course because no one is consistently paying attention. If the problem is left to go 10 years like the IUL example the fix is very expensive. Perhaps the biggest difference between policies that work and those that do not is the presence of ongoing written reports that reconcile the policy.

- **Access to Variable Products:** Anyone claiming to be an insurance professional cannot consistently act in clients' best interests without having access to variable products. There certainly are times when variable products are not the best option for clients, but there are many circumstances where well-designed and serviced variable products allow the 400-500 basis point earning of equities over bonds to accrue to the client's benefit.

No one has summarized this better than Ken Samuelson, Principal of Morehead Group, who said of insurance, "design conservatively, administer aggressively."

If you would like to see more details on the actual policies that this post is based on and discuss how Valmark assists firms to offer 10X insurance solutions, I would be glad to take a call. We even have a scorecard that you and your team can use to assess where your firm's offerings are on a scale of 1-10. You can get a copy of the scorecard by emailing Brandy Friedt, M.A. at bfriedt@valmarkfg.com.

I know for certain that this post will draw comments and questions, and I welcome your thoughts.

Disclosures

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Variable universal life ("VUL") insurance policies combine the premium and death benefit features of life insurance with the ability to allocate a portion of premium payments and cash value among a variety of investment subaccounts. The principal value and returns of the subaccounts and cash value are not guaranteed and will fluctuate with market conditions and other factors. For more information about any VUL insurance being considered, including its product features, charges, and expenses, please read the prospectus of any policy considered carefully before investing. Guarantees are based on the claims paying ability of the insurance carrier offering the guarantee.

Indexed universal life ("IUL") insurance is a type of permanent life insurance that combines a death benefit with a cash value component, offering policyholders the opportunity to grow their savings with a level of risk tied to a market index. These products do not directly invest in equities but instead are funded by the general account of life companies. IUL policies are inherently complex, providing flexibility in premium payments and the potential for adjusting death benefits to align with evolving life circumstances. The cash value component of an IUL policy is a significant feature that differentiates it from other life insurance types. The policy's cash value grows based on the performance of a selected market index. However, IUL policies typically include a "cap", "floor" and "participation rate". If return rates don't meet expectations, premiums could increase, insurance coverage could decrease, or the policy could lapse. Investment earnings accumulate on a tax-deferred basis.

· The “cap” in an IUL policy is the maximum interest rate your IUL policy can earn, even if the index performs better. The “floor” is the minimum interest rate your policy is guaranteed to earn, protecting your cash value from market downturns. Guarantees are limited by the claims paying ability of the issuing insurance company.

· The “participation rate” dictates how much of the return is credited to the policyholder. While it is usually 100%, the insurance company can lower it. For example, with a 10% cap and an 80% participation rate, the policy that tracks an index performing at 12% return, would be credited with an 8% return rate. (80% of the 10% Cap)

Investors should carefully consider all variable life insurance products’ risks, charges, limitations, and expenses, as well as the risks, charges, expenses and investment goals/objectives of the underlying investment options. This and other information about Lincoln Variable Universal Life Insurance Company products are provided in the applicable product and underlying fund prospectuses which are available from your life insurance producer or by clicking here. Read them carefully before investing or sending money.

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