## Audio file

NK12 - Policy Stewardship.m4a

## Transcript

Hello and welcome to the New Knowledge podcast. My name is Mark Summer, partner of Newton Advisors, and I'm joined today by not only my colleague Stephen Target, managing partner of our firm, but also Amy, Mr. our Director of underwriting and Brittany Navala, our lead client service Rep the Newton Knowledge Podcast. To provide meaningful content to our valued advisor, community and clients who are interested in learning more about sophisticated insurance related topics. Focused on estate planning and executive benefits, during our podcast, we focus our discussions on content that will deliver unique insights to the people, processes and products that make our industry so critical. We want as a national life insurance planning firm delivering customized insurance solutions structured to help clients and their advisors engaged in solving the state planning. Wealth transfer, business succession and executive benefits. Changes we are a member of the Umm Financial Group, offering our clients access to the nations most prestigious insurance carriers and innovative products available only through our network. Today, we're keeping everything within the new one family figuratively and somewhat literally considering anybody our actual sisters. But what I mean is our our focus will be on our internal. Policies and procedures emphasizing the importance of ongoing servicing and management of life insurance policies. This is our 12th episode. We attempt to select topics that hopefully provides value and insight to our listeners, and no host or second is more or less imperative than the next. But this episode and topic is invaluable. It truly keeps this train running, if you will, with England. Britain being the. Conductors majority of our engagements and implementations require elite knowledge and experience, beginning with underwriting implementation and policy audits and reviews. I'm going to sound like a broken record, but Brittany and Andy play such an important role in making our clients experience and continued involvement. They are true differentiators within this marketplace and we thank you and I know our clients and partners of our firm are extremely appreciative of the dedication and work you too do. So thanks. I digress. So and Brett, I see you've pulled up some statistics on why policy stewardship is so important. I glanced at a. Few of them earlier, and some are very. Surprise me.

Well, for starters, only 29% of trustees have reviewed policies in the past five years, 84% of agents or firms not having any guidelines or procedures in place for annual reviews or reallocations, and 70 to 95% of policies or insurance do not have a servicing.

One of the most eye opening statistics I saw was 92% of existing policies could be restructured to provide provide more value to the client. The question stands, you know, why should you restructure them or even consider that? And 1st it should begin with the clients capital need. How much death benefit is sufficient? Are the proceeds that were placed five to 10 years ago adequate protection now, as the client acquired more assets, less assets has a change in family dynamics taking place. Have they sold a business or coming to a large inheritance? There is a multitude of scenarios that will change. The necessary amount of insurance protection being one of the more fundamental simple review steps. Surprising how infrequently this type of analysis performed. Second, if it's a permanent policy, what were the goals for placing it and how is it structured to meet those objectives? Was it for wealth transfer reasons where you traditionally focus on minimal premium to death benefit was for cash accumulation purposes for supplemental retirement income, providing tax for growth with income tax free distributions when

structured properly. Another good question here is how did they decide on the permanent solution to use? In some certain companies or agents, they only have access to two or even sometimes one permanent. Product unintentionally limiting a client's opportunity to see and understand the numerous amounts of permanent vehicles.

That are available.

The last piece, and surely not the least, is how is the policy performing and depending on the actual type of contract, most permanent policies have some form of crediting rate that dictates the the cash growth. This rate can mirror an index. Reciprocated dividend rate will be based off separate account performance performance similar to mutual funds. It depends on the type of policy and we'll touch on this in. Greater detail later. On but monitoring this performance allows for proactive adjustments to be made if need be based on year to date performance. These reviews are becoming more prudent due to the Great deal of volatility in both the markets impacting separate accounts as well as the incessant low interest rate environment which has negatively impacted cash accumulating universal life policies and whole life insurance policies. Additionally, the costs associated with index universal life contracts have increased. Which has impacted the ability for carriers to maintain such high caps on index universal life programs. Another item. To be aware. Of when policies are owned by Life Insurance trust and this is a very common practice with our. Intel, like any asset holding trust, the trustee of a life insurance policy has a fiduciary responsibility to review trust owned life insurance and ensure that the policies are performing adequately. Failure to do so may result in litigation for with the trustee is personally liable per the uniform Prudent Investors Act may be wise to take. Note if you happen to be the trustee on trusting life insurance policy, or if you have a trust owned policy in place. And you're having a hard time remembering the last time you reviewed it with your trustee. Steve, I'd like to revisit the different types of structures of permanent policies, their associated crediting rates, and why reviews should be a key practice for such planning. Yeah. Thanks, mark. And I, I think that this part of the conversation is really based on an understanding.

Of how life insurance policies are priced and why it's so critical for us to continue to look on an ongoing basis at the performance of the policy. So if we start with kind of a a basic understanding that all permanent life insurance policy. These are priced or structured off of some assumption of an interest rate, and so if we if we kind of go through the different types of life insurance policies we've we've got a universal life grouping of policies and those can be current assumption policies. They can be indexed universal life, they can be variable universal life. And of course, there's whole life insurance policies as well, so that the the basic understanding is that there's an inverse relationship between the crediting or the interest that is associated with the policy and the premium that's. So his policies are being priced a lower premium in order to keep the policy in place for the duration that's desired needs simply a higher crediting rate and a higher crediting rate is generally an interest rate that we can look at over a long period of time, for example in in variable universal life. Policies that crediting rate is based on the performance of the underlying separate accounts, and that that's in the insurance world we call them. The underlying accounts separate accounts for many people. They refer to them as mutual funds, but in the insurance world we call them separate accounts. The other side to that equation is a current assumption, sort of universal life insurance policy, which generally has a short term interest rate crediting which then means that a higher premium needs to be. To make up for the lower interest that's being credited to the policy and one is not right and one is not wrong, it's just a matter of risk tolerance of the of the insured or the owner of the policy and over time what we do know is that whatever we put

together or whatever an insurance agent illustrates is simply not going to come to actual fruition. As it's illustrated it it just it can't, it can't happen. If we illustrate a a a gross growth rate in a variable universal life policy of 6% for example, you know you might achieve a 6% right on the number in one year, but the next year it's not going to be 6% or will be higher or lower. So This is why it's so important for us to go back every year and revisit what the actual crediting rates are, whether it's a variable universal policy that has separate accounts that are going up and down or a current assumption, universal life policy that has moved a little bit slower. But why it's so important every year to look at what the original illustration. Was and with the assumption was on that crediting rate versus what the actual performance of that policy was. And so if we look at the life insurance death benefit as an asset. And understanding that we need a certain amount of premium to be paid on an annual basis and then a certain assumption made or actual crediting on an interest rate, what we know is that over time we may need to make adjustments to the premiums that are actually paid. So if the performance of that crediting rate is better than what's illustrated. There's a chance that the premiums paid moving forward. Be lower and conversely, if the interest rate is lower then we might need to pay a higher premium to keep that policy in place for the duration. So again, this just validates the fact that on an annual basis we need to go back or we should be going back or any insured or owner should be looking at what the original illustration was, what the assumptions were based on the interest. Cutting rate and how the policy is actually performing, so even whole life insurance which is deemed or sometimes believed to be the safer sort of life insurance policy, there's an interest rate that's that's attached to that policy as well. And that interest rate is part of the dividend. That's paid so when the dividend, there's three components we have an interest component, we have a mortality expense and then general operating expenses. But one of those 3 components is the interest rate. So a whole life insurance carrier, mutual insurance carrier that's investing their assets in the general account is subject to ups and downs in the market. Like any other investment, so even whole life insurance policies have some assumption made with the dividend. When the policy is taken out. And again, even those need to be reviewed. To assume to go back and and look at the actual performance versus the assumed performance. The other expenses that are associated in whole life policies are they disclosed to the client or the advisor not directly. So whole life insurance policies are kind of a a blended sort of expense ratio. It isn't as clearly defined as other sorts of policies. Now the the most transparent in terms of expenses is a. Private placement insurance policy. We're not going to have that discussion in this podcast directly with the private placement is probably the most transparent in terms of what the operating expenses are, what the mortality charges are.

And of course, because that's a variable sort of policy, what the separate account performance could be anytime, permanent policies are discussed, whole life usually leads that discussion with most clients. The dividend interest is one of the the main components of that discussion. But there's other variables that come into play in terms of expense.

So and I think. It's also important to note that you know. There's a lot of our prospective clients that use the term whole. Place kind of too broadly, you know, they think that that they have an, a, a whole life insurance policy and might in fact not be a whole life. There might be a universal life insurance policy because back in the day there was only her life insurance and term insurance and universal life as a as a product. And I think really took a hold in the early 80s. When clients say or when advisors say you know I've got a whole life insurance policy, we'll typically kind of tap the brakes and make sure that we're looking at a whole life, not a universal life contract. And the other issue that has complicated the review process with regard to interest rate assumptions. Is some new regulations for indexed universal life

insurance policies, and these are the AG 49 regulations which really limit and in some ways this is a good thing, but they limit what interest rate we can illustrate not only on new policies but also on existing policies. And I say it's a good thing. Because what we don't want in the insurance industry is we don't want rogue agents that are illustrating completely unrealistic interest rate assumptions. So it is good from that perspective that it that it helps. Really validate what the the likely interest rate crediting would be on an indexed universal life insurance policy, but the challenge is that number changes on on some cases on a monthly basis and from carrier to carrier based on how that policy is actually structured. We we don't want to get into. Details of how index universal life insurance policies or structure. But there's a floor and there's a cap on it. History that's tied to some index. In many cases, the staying power 500 index, so that creates a real challenge as we serve as policies because what was illustrated originally, which may very well have been a very conservative illustration today based on the regulations we might not even be able to go back to that. Interest rate assumption again, from our perspective it it still may be the right number or the interest rate that we feel is appropriate moving forward. But based on the regulations, we simply can't actually illustrate how the policy will perform moving. Forward and that creates some, in our opinion, some potential misunderstandings about how index universal life insurance policies could perform. And I guess the last thing I'll note is just, you know, as we're as we're talking about structuring policies where there's really a difference and we talked about this a lot and warn about the difference between competitive. Pricing and sound pricing and what we mean by that is competitive pricing is perhaps illustrating interest rate assumptions that are too aggressive and by doing that, again remember the inverse relationship of interest rate and premiums. If you have an unrealistic interest rate assumption that. Which you say is too high. Then the premium required in order to keep that policy in place might be too low. And we just don't think that's a good way to to to not only illustrate, but also to structure policies. So the sound pricing philosophy, which is where we abide by, is making sure that the interest rate assumptions that we make on illustrations are appropriate based on what we believe is the the right assumptions. We may moving. Forward and we would much rather be a conservative. On an interest rate assumption to soundly price the policy to have premium payments on an annual basis that are appropriate. And if the policy outperforms or the interest rate that's actually credited is better than what was illustrated, then the good news is we might be able to decrease the premiums moving forward or at some point actually eliminate premiums moving forward. So if we have these conversations on an annual basis, just like anybody would have reviewing their investment portfolio or reviewing any sort of future looking growth component, if we have this conversations on an annual basis, we can stay ahead of changes versus getting five 10-15 years down the road and trying to do some. Match up or some makeup so it's table stakes for us and we're we're fortunate that we have such a talent. Team that understands how policies are priced, how they understand how policies perform, and you know I can tell you that on a on a regular basis, we challenge each other to make sure that the policies are appropriately structured and performing how they want the policy. To perform moving forward.

All good points, Steve. And it it's funny having a policy that's soundly priced it. It's all intertwined when it goes. To the review process and and kicking back to England and Britain, starting with the policy that's implemented that is fairly priced, you guys are in the trenches, but I can only assume ongoing that it kicks up for easier conversations on annual reviews because the policy was put in at an appropriate crediting rate. Do you want to go in a little detail on how that process looks and what our procedures look like internally when you are doing? Reviews for our clients.

Yeah, Mark, Steve, you just listed a bunch of good points regarding the structures of the policies and it it, it's clear that the lack of review and servicing of these life insurance policies be put in place can have a significant impact on the performance review process we provide here at Newton. One is not only a good time to compare the performance. For the original baseline, we put. In place, but also to look into any changes that need to occur going forward. These changes could include ownership changes or beneficiary designations. Many times our insurance have life life changes and we need to make updates to the policies we can look into fund allocation changes to reallocate the funds. Going into the policy to look at different performance outcomes, as Steve mentioned before, premiums may need to be changed, whether up or down or for the trust and policies we have out there. There are many times trustee updates that need to be made for those trustees that manage the policies. All of these factors play an important part in the success of our life insurance policies here in Newton, and we do have a strong team here in place to to make sure that happens.

I will go off. Of what Amy said and Steve, he commented on how the policy should be reviewed minimally on an annual basis. As you mentioned, we use the illustration as a benchmark to base our performance for our annual reviews. Anytime there is a premium change to the policy, we will. Update the benchmark or the baseline to reflect that change so that we're getting a. More accurate picture of how the policy should be performing.

Thank you, Brett. It's all about open dialogue regarding the the original goals of the policy versus goals based on current circumstances. In order to do this, the question is alright, we want to go through the review process. So how does that look? Well, first we need current enforce illustrations showing the projected values moving forward with appropriate interest rate assumptions. Once we have that, then we can then again go back to the client, do a fact find, see if it's aligned with their goals and objectives, or if if it's not sufficient or if it is and our our founder says this all the time and and I reiterate it. You know, Steve does as well, if there's not going to be a material or substantial change. The policies in place that are going to be truly advantageous and substantial. For the client. And their their legacy planning or or for the family, then we're not going to make a change and that's just as as simple as the king. Yet I will say that due to the advantages we we are fortunate enough to receive through the M financial family and the exclusive products and and pricing and how our policies. Work more efficient or more efficiently functioning? I would say 9 times out of 10 depending on the clients health at that time. We're usually capable of finding solutions that are going to be substantially materially different and beneficial to the client or the engagement that we were brought into. What are some of the potential? Outcomes of the. Review one being restructuring the policy. With with the current carrier. In the order and again this is to align. With the current goals and objectives, so maybe we're going to extend the duration of cover. Large, maybe cash value growth is more ideal and we need to structure the policy differently, minimizing death benefit proceeds and maximizing the cash value. Restructuring the policy with the new carrier, you know this carrier now is a player in in that planning technique due to the the change in in lower mortality. Charges and possibly other internal expenses carriers are using updated mortality charts, which are more favorable for certain insurers and certain rating classes and certain medical history. That's just. Knowing the carriers. From an underwriting standpoint, which Brittany and Amy are again second to none in those regards in in terms of restructuring the policy adding riders is a is another advantage, especially long term care nowadays and that's more for the planning aspect. You know a lot of our clientele I would say can self fund, but it's not so much for the actual. Funding for long term care needs. It's the planning or the dedicated funds that are. Set up towards planning within these life

insurance policies. So rather than having to liquidate assets or take funds elsewhere, having a dedicated long term care rider within certain life insurance policies is a nice way to delineate this is what's going to be be used for long term care facilities or long term care needs. For example, if you have a whole life policy in place and restructure it to one of M financials, proprietary products, say and index universal life with nationwide and tacking on a long term care. Rider performing a 1035 exchange from the cash within the whole life policy to that index. Universal life policy with long term care rider with potentially reducing premiums in doing so is a huge win for the client. Then then the question goes, well, what if the insurance policy that was put in place just isn't needed anymore? It has done its job in in terms of estate tax requirements. The the there there may not be one or there may be other policies in place to to mitigate that fully or assets have been gifted out of one estate to where there is no estate tax and. There's just a policy that's simply not beneficial for the client. This is when life settlements come into play or radical settlements, and we partner with with certain advisors that focus purely on life settlement transactions. And this is where the sale of the policy in regards to a third party would take over the the policy and once the. The applicant passes away. In turn, they would receive the death benefit proceeds in terms of the value of the policy. Usually health comes into play. And the duration or longevity of that client may not be as. Lengthy or in terms of how much they they are willing to pay would be dependent upon how long that client actually is going to be with us. So in terms of life settlement, sometimes that can be a advantageous play for the client and the family. If there's policies that are no longer needed benefits wise. I think that's it. I I think we covered everything again in terms of monitoring, servicing and auditing the policies is as every bit as important as putting the right policy in place, soundly priced, that's all we have today. Thank you so much for joining us. And again, thank you, Brittany Amy, for your support. We wouldn't be able to do what we do. Your new one if it. Wasn't for you too. Have a great day. The material and opinions voiced are for general information only and are not intended to provide specific advice or recommendations for any individual to determine what is appropriate for you, please contact a member of our team.

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