ADVISOR STRATEGY: THE SUB-PRIME LIFE INSURANCE POLICY.

Some mortgage salespeople and brokers sold sub-prime mortgages with escalating payments to consumers who didn't understand the complex contracts. A similar case might be made for many life insurance agents, who sold policies under the pretense that the policy would provide lifetime protection, cash values, and sometimes a "paid up" feature on various types of policies and from many major insurance companies.

A while back, a friend asked me to take a look at his life insurance policy. He had paid $500 per year for 19 years on a $100,000 universal life policy that was "collapsing" in three years. It would require $1,900 annually to hold the policy into his 90s. Insurance tax law limited the policy to a premium that was insufficient to hold it to maturity.

This policy owner got annual statements from his carrier, but no notice that his policy was on track to fail due to changes in the crediting rate. I started to think about comparisons. I imagined having an adjustable rate mortgage (ARM) on my home and the mortgage company not notifying me when the rates changed. I would just keep making payments until I got a foreclosure notice.

Outrageous? This is how many "permanent life insurance" policies work! Very few policies are guaranteed the way a policy owner thinks they are. Crediting rates on the accumulated value change along with financial markets (usually with some guaranteed minimum). Inadequate policy funding may eventually deplete the policy if rates decline as they have for the past 25 years Yearly statements may even show the cash value increasing, but possibly not fast enough to sustain the policy through maturity. But the carrier doesn't provide notice of inadequate funding or define what can be done to ensure the policy's viability. Also, this has not traditionally been part of producer training for policy servicing.

The cash accumulation of a permanent insurance policy is analogous to funding a retirement account. A 25-year old woman can calculate that she needs to invest $2,054 a year if she decides that she will need $1 million in her 401k to retire at 65 and she assumes a 10% annual return on investment. However, if she ends up averaging 8% on her investment, she will only end up with $574,000 if she doesn't adjust her rate of savings. If the account is not monitored, she will not notice that she is saving too little and will not get the retirement income she needs. If the same thing happens with a life insurance policy with premiums that were set based on assumptions of crediting rates at the time of purchase, the policy will fail.

The Life Insurance Audit team helps professionals and businesses protect their most valuable assets using tax-favored strategies and products.

The bottom line is that the most basic financial investment that consumers depend on to protect their family or business is probably not performing as projected and probably has a shorter life expectancy than they do.

As a long time life insurance professional, what I found while performing hundreds of Life Insurance Audits is that there were many clients whose interests were not being served. The problem is very real.

Permanent life insurance is unquestionably one of the most complex and least understood products sold to American consumers. As a consequence, they rely on life insurance carriers, whose marketing message is, "Trust me, I have your best interest at heart." Even the product name (permanent life insurance) implies that the policy will last a lifetime.

In dealing with policy owners and advisors, we explain that policies need to be managed like any other financial investment not only to survive, but also to perform as well as possible. Any well-trained life insurance producer will say that life insurance is not like any other financial investment. Yes, all financial vehicles have unique characteristics, but they have basic similarities. They are evaluated for purchase, monitored for performance, and divested as appropriate. For the friend with the failing policy, we found a $100,000 policy with a lifetime guarante for less than half the cost of trying to salvage his old policy.

The insurance industry has worked hard to teach consumers that life insurance is a valuable piece of property, but the companies have little incentive to help clients manage this asset and significant agent turnover/departure leaves many clients as "orphans" -poorly serviced and on their own. How many policies are being managed actively by the policy owner, agent, or advisor? The industry disparages life settlements, often forbidding their agents from mentioning them even when they may clearly in the best interest of the policy-owner.

The sad truth is that, too often, the life insurance industry relies on consumer tremendous lack of attention and naïve ways. They don't support a policy owners right to buy, manage, and divest of this asset in a way that suits them, and not the carrier. The lack of attention to policies is generally disastrous to clients and their future insurance needs.

Auditing a policy, periodically reevaluating the need, managing the policy on an ongoing basis and, at times, divesting the policy as efficiently as possible, should all be considered.

If you don't want to find yourself in the same position as a surprising sub-prime mortgage adjustment, each insurance policy you own must be regularly and routinely audited and benchmarked. ■

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