Take Stock Of Your Clients' Existing Policies

BY BARRY D. FLAGG

AN EVOLUTIONARY SHIFT, currently under way within the life insurance industry, stands to have a significant impact on marketing and sales while enhancing results for financial advisors and their clients.

In order to maximize effectiveness within this new environment, advisors are adopting a fresh approach to their practices while tapping into new tools and resources. This movement toward Life Insurance Portfolio Management, which is being fueled by an array of converging factors, is transferring life insurance policies into the realm of transactional assets and out of the long-held mold in which clients tended to give very little thought to a particular policy once they had completed the task of purchasing it.

As such, Life Insurance Portfolio Management is creating a new framework for fee income, market differentiation, information exchange and relationships.

TOWARD A NEW MANAGEMENT MODEL

If it is difficult to envision life insurance protection as a transactional asset that is managed within a portfolio, think back to how investments were sold just a few decades ago—before mutual funds, before 401(k)s and IRAs, before standardized performance reporting, third-party information resources, and just about everything that is now taken for granted in the investment business. Stockbrokers used to sell investments. Now, advisors sell "investment services," based on a set of predefined parameters and an assumption that adjustments will be made to the portfolio as economic and market conditions change and new opportunities arise. Not surprisingly, an exponential increase in trades on all of the major exchanges has accompanied this shift in perception.

A similar mix of market and regulatory forces that reshaped the investment business is now at work within the life insurance business. Key among them:

▸ **A growing awareness that the tremendous volume of capital tied up in insurance policies can represent missed opportunities.** Whether purchased for wealth accumulation, where managing cash values to maximize growth is the policy objective, or death benefit protection, where managing cash values to minimize premium payments is the policy objective, life insurance policies constitute the largest pool of unmanaged consumer capital in the entire financial services industry. Indeed, cash value accounts amount to more than 200 million in-force life insurance policies and total more than $3 trillion of unmanaged, invested assets.

While the individual investment holdings underlying these cash value accounts are professionally managed in accordance with the insurance company's portfolio objectives, the pricing and performance of the life insurance policies that are holding these cash values are not being professionally managed on the policyholder's behalf. By contrast, within the $6 trillion mutual fund business, there is a vast array of research, services and support designed to help investors to maximize opportunities and understand their options. It is inevitable, given the size of the market, that life insurance assets will soon become subject to a similar level of scrutiny.

▸ **The introduction of "investment grade" life insurance products.** Generally speaking, universal life has been marketed to policyholders during times of high interest rates, and variable products were viewed as attractive options when the market was up. High projected interest crediting rates and high projected investment earning rates gave the appearance of artificially low premiums in defined death benefit, minimum premium plan designs, and artificially high cash value growth in defined contribution, maximum accumulation plan designs. Due to declining interest rates on UL products and uncertain market performance for Variable Universal Life products, portfolios need to be actively tracked and managed according to clients' needs and expectations, and with the understanding that it is impossible to project accurately long-term policy performance based on assumptions made at the time of the sale.

▸ **The emergence of an official life settlement secondary market.** Clients now have unprecedented opportunities to sell insurance policies that no longer suit their needs, in order to purchase more appropriate insurance or investment instruments. In such circumstances the life insurance agent or financial advisor serves as a broker or market maker who arranges for the trade.

▸ **The emergence of new service providers.** The potential for Life Insurance Portfolio Management is fueled by various types of third-party providers and consultants that offer a range of dynamic portfolio management tools. The scope of services include:

- Manager of managers investment-type services for the mutual-fund-like separate accounts within VUL policies;
- Policy comparison and audit systems that collect and compile data for purposes of comparing policy illustrations and company ratings, and reporting on the status of in-force policies;
- Benchmarking capabilities that compare

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GETTING THERE

A FIVE-STEP PROCESS

Based on a disciplined and objective process, Life Insurance Portfolio Management consists of the following five functions:

1. **DEFINES PORTFOLIO OBJECTIVES.**
2. **MEASURES PORTFOLIO PRICING** and performance.
3. **IDENTIFIES STRENGTHS AND WEAKNESSES** of products in the portfolio.
4. **INVESTIGATES AVAILABLE INSURANCE** or investment product alternatives.
5. **MAKES CHANGES NEEDED TO MAXIMIZE BENEFITS** and minimize costs. If no adjustments are warranted, determines parameters for potential future changes.

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TAKE STOCK

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various aspects of policy pricing components, including cost-of-insurance (COI) charges, fixed administration expenses (FAEs), cash value-based "wrap fees" (M&Es), premium loads charged by the insurer, and the policy interest/earnings credited to premiums paid in excess of these policy charges, as well as the historical performance of invested assets underlying the policy cash value, and the stability of policy pricing.

Convincing clients of the opportunities inherent in Life Insurance Portfolio Management depends, in large part, on how it is positioned. Keep in mind that many clients might be suspect of "The Next Big Thing."

A few decades ago, around the same time that mutual funds were becoming popular, the government came out with a study that led many to the conclusion that whole life insurance was a bad investment. This sparked an industrywide campaign to replace whole life policies with UL policies. As interest rates fell and markets rose, VUL became increasingly popular.

Clients and their advisors now are confronting the realities of UL and VUL policies that were projected out for 30 years, even though rates were never guaranteed.

Nevertheless, the solution is not a new product. Life Insurance Portfolio Management is a *process*—one that identifies objectives and employs new analytical tools to optimize opportunities and enhance the exchange of information. The outcome of the Life Insurance Portfolio Management process can vary widely—depending on the objectives of the policies. Once clients have the opportunity to review current policy performance relative to their current goals and expectations, options can range from:

- **Adding funds to the policy** to maintain wealth accumulation objectives or to keep death benefits current;
- **Reducing policy benefits** to reduce corresponding policy costs as to cost of insurance charges, fixed administration expenses, cash value-based "wrap fees" and premium loads;
- **Changing the asset allocation** or investment mix of invested assets underlying policy cash values;
- **Trading existing policy holdings** with higher costs structures in favor of policy issues with lower costs structures (a 1035 exchange);
- **Selling existing policy holdings** on the life settlement secondary market for more than the cost to repurchase the same coverage in the open market (i.e., sell high and buy low and the client keeps the difference);
- **Taking a "wait and see" approach** in cases where a policy or portfolio of policies is below target funding objectives but within expected ranges, and cash values are sufficient to support portfolio costs for some number of years and there is no immediate risk of lapsed coverage.

Life Insurance Portfolio Management sets the stage for a high level of strategic differentiation for agents and advisors. It calls for a renewed commitment to current clients, as well as a means to measure and report on various facets of insurance costs and rates or return against industry benchmarks. The inherent objectivity of the process builds confidence among clients and mitigates against a perceived need to seek competitive bids.

In short, Life Insurance Portfolio Management builds trust, builds bridges and builds business. NU