WHY YOUR LIFE INSURANCE NEEDS PERIODIC REVIEWS

INSURANCE INSIGHTS

Life insurance is a powerful tool with unique tax advantages that can help ensure your and your family's financial security.[1] Your policy is a sophisticated and complex financial instrument and, therefore, not a "stick it in a drawer and forget about it" type of investment. As your life and the world around you evolves, your life insurance policy may need to change with it. What met your and your family's goals and objectives in the past may not meet those needs today.

Many factors affect the suitability and performance of a policy. Regularly evaluating a life insurance policy is essential to ensure that it is still meeting your and your family's needs. Initially, a comprehensive review is advisable but, over time, it will require fine-tuning. An experienced financial professional who can lead you through the maze of competing and complex factors is essential.

THE NEED FOR LIFE INSURANCE

The starting point of a policy review is to determine the current need for insurance protection. Many changes in life circumstances can affect the suitability of and need for your policy.

Common events that can alter life insurance needs:

- Marriage or a new life partner
- Divorce
- Having/adopting a child
- A child moving out or becoming an empty nester
- New grandchildren
- Buying a home
- Retiring
- Relocating or a job change
- Buying, selling, or growing a business
- Adding or losing a business partner
- A noticeable increase (including an inheritance) or decrease in net worth
- A change in health status or lifestyle habits

The current need for insurance may be completely different than the original one. For example, a policy purchased to protect a spouse's earning power during his or her working years may no longer be needed due to retirement. Can the policy be repurposed to provide retirement income? Should it be transferred to a trust to efficiently pay estate taxes or donated to a favorite charity?

Finally, if the insured is in poor health and there is no current need for life insurance, it still may be advisable to keep the policy in force since he or she may need coverage in the future but may not qualify again.

If, after very careful consideration and exhausting all options, it is decided that the insurance will be surrendered, a life settlement (discussed below) may be an option.

THE REVIEW

Once a current (or future) need for life insurance is established, the policy can be evaluated in a seven-point review. This review will cover the following areas:

- Amount of insurance
- Owner, insured, and beneficiary
- Policy type
- Policy performance
- The insured's health
- Carrier financial strength and claims-paying ability
- Legal and regulatory changes

Below is a breakdown of each point for review:

1. AMOUNT OF INSURANCE

The amount of insurance to meet your needs may have changed over time. Your estate may have increased significantly or your estate tax exposure may have decreased due to increased lifetime gift exemptions.[2] For some, the scheduled "sunset" (reduction by one-half) of gift and estate exemptions on December 31, 2025, will lead to a significant increase in estate taxes.

If you own a business and it has a buy-sell agreement, there may also need be periodic adjustments to the amount of insurance tied to the plan. For instance, your business value may have increased, a shareholder may have died or retired, or a new partner may have entered the business.

2. OWNER, INSURED, AND BENEFICIARY

There are three key parties to a life insurance policy: the owner, insured, and beneficiary. It's important that these designations are kept up-to-date to reflect any changes in tax laws or your life.

For instance, if you bought your policy when you were single but then marry, you may want to change the policy beneficiary to your new spouse. And second-to-die (also known as survivorship) coverage insuring you and your spouse may be more appropriate than current single life coverage insuring you alone.[3]

Another example is if your net worth has increased, you may want to consider transferring the policy to an irrevocable life insurance trust (ILIT)—especially with the impending estate tax limits due to decrease, as mentioned above. By transferring the policy to an ILIT, the trust becomes the owner of the policy, which keeps the proceeds out of your taxable estate. Although you would give up all ownership rights to the policy, more could be left for your beneficiaries.

In the case of a buy-sell, it is important that the ownership and beneficiary designations match the party with the legal obligation to purchase a deceased partner's interest in the business. For example, with a redemption buy-sell agreement, the business is legally obligated to buy a decedent's interest. As a result, the business should be the owner and beneficiary of the policy.

3. POLICY TYPE

It is important that you have the proper type of policy to meet your needs. For example, you may have purchased term insurance for what now could be a permanent need if you have substantial estate tax exposure (in spite of today's high exemptions). If this is the case, second-to-die (survivorship) life, which insures two spouses and pays on the second death, may be a more appropriate and cost-effective form of coverage to meet estate tax needs than single life term coverage. Would you prefer to control policy investments rather than having the insurance carrier invest in its general account? Is the price you're paying for fully guaranteed coverage worth the cost?[4] Even if you've had a major health change, convertibility is an often overlooked feature of your term insurance policy that may allow you to convert the term policy without evidence of insurability to a permanent policy.

4. POLICY PERFORMANCE

Depending on the type of policy, fluctuations in the stock market, interest rates, and carrier investment returns may impact your policy's performance. The policy may have performed better than expected making it possible to skip a premium. On the other hand, impaired performance can put the death benefit at risk and call for additional premiums to maintain the coverage. For example, premiums may not have been paid on time, policy cash values may have been reduced through loans and withdrawals, or policy investments may have underperformed.

Consequently, it is important to regularly review any life insurance policy to ensure that it is performing as expected. Your financial professional can provide an in-force ledger illustration showing how the policy could perform in the future based on how it has performed to date, as well as current pricing and other assumptions.[5]

Trustees of life insurance trusts, who are frequently family members, have a duty of care to trust beneficiaries and can particularly benefit from a periodic review to reduce liability exposure.

5. INSURED'S HEALTH

Your current health is an essential element of the insurance review and can be important in deciding what, if any, premiums will be paid moving forward. In addition, your health will be a key factor in determining whether new coverage is available and advisable. In many cases, it will be preferable or even required to be medically underwritten to determine the true cost of new coverage.[6]

Medical underwriting determines the policy premiums based on the prospective insured's risk classification, which could range from preferred best to highly rated — but each life insurance carrier underwrites differently. For example, one carrier may treat heart conditions more favorably than others or a carrier may have a system of credits that gives greater weight to positive lifestyle behaviors such as regular exercise. Importantly, a carrier's medical director will carefully monitor new advances and treatments to help a carrier maintain competitive pricing.

6. CARRIER FINANCIAL STRENGTH AND CLAIMS-PAYING ABILITY

The insurance industry is highly regulated. Nevertheless, the financial strength of the issuing carrier is essential to its ability to meet its promises and ultimately pay death benefits. Over the years there have been a few high-profile carrier failures.[7] It is, therefore, important to monitor a carrier's financial health. A number of independent ratings agencies, including A.M. Best, Moody's, and S&P Global, rate various aspects of a carrier's financial strength and claims-paying ability. A downgrade of your current carrier could be cause for concern and thus a carrier's ratings should be regularly monitored.

7. LEGAL AND REGULATORY CHANGES

Changes in federal and local laws can also affect life insurance policies. Unfortunately, the federal estate tax laws have become a political football. As control of our government shifts between parties, these laws seesaw between higher and lower tax regimes. Changes in tax laws or regulations may dictate ownership changes or in the amount and type of coverage.

SURRENDERING COVERAGE AND LIFE SETTLEMENTS

Frequently, a policyowner may consider surrendering coverage when it is no longer needed. If, after very careful consideration and exhausting all options, it is decided that the insurance will be surrendered, a life settlement may be an option.

In the case of permanent insurance, upon surrendering the policy, the owner will receive the cash surrender value. The policy may, however, have substantially greater value if sold to investors on the secondary market in what is referred to as a life settlement. Many safeguards, including blind trusts, have been put in place to protect the identity of insureds so that the investors do not know their identity.

Even a term policy may have substantial life settlement value provided it is still convertible without evidence of insurability. Your financial professional can help you review the pros and cons of a life settlement, assess its appropriateness, and shop the secondary market to obtain the best offer.

THE ROLE OF THE FINANCIAL PROFESSIONAL

The health of your life insurance program is critical and is not just limited to policy and carrier performance. Life insurance sits squarely at the intersection of:

- Changing family dynamics, goals, objectives, and the desire to create harmony and financial security
- Societal changes
- Complicated tax laws
- A sophisticated personal, business, estate, or charitable plan

Because life insurance can be affected by so many factors, a periodic review is necessary to update your policy. Your financial professional can work with your tax and legal professionals to ensure that your policy still meets your investment and estate planning objectives, and may identify a product that is better priced or suited based on changes in your life, as well as the financial and legal landscapes.

This piece was created by M Financial's Advanced Markets experts and produced by the marketing team.

[1] As a general rule, life insurance death benefits are income tax free, and when owned by a carefully drafted trust, the proceeds can be gift, estate, and generation-skipping transfer tax free.

[2] In 2023, a single individual can shelter $12.92 million of assets from gift, estate, or generation-skipping transfer tax exposure and a married couple can shelter $25.84 million.

[3] Second-to-die (survivorship) life is significantly less expensive than two single-life policies for one-half the coverage on each spouse.

[4] See M Intelligence piece, Guarantees: Are They Worth The Extra Cost?

[5] An in-force ledger is not a prediction of future performance. Rather, it is an example of how the policy could perform based on performance to date, current pricing assumptions (cost of insurance charges, expenses, and fees) and controlled but reasonable future assumptions (earnings on policy cash values).

[6] When underwritten, even with the best of results, there is no obligation to purchase new coverage.

[7] Because of state insurance funds and carrier support, policy beneficiaries have typically received substantial value from their policies.

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