A Plain Jane Policy Analysis

An estate planning attorney introduced me to a client of his who was the trustee of her parent's irrevocable trust that owned a $4 million dollar second-to-die policy. As is typical in these scenarios, the trustee understood very little about the insurance and her father was the one "in charge" of the policy over the years but he didn't understood it much better.

To anyone who does something every day, it may be bewildering that their respective specialty is so entirely misunderstood by others. So it is with life insurance. I understand it can be a mystery to many, and in some ways it is ridiculously complicated, but I am often reminded that I can take nothing for granted when working with consumers.

This case was as typical as an engagement can be. The $4,000,000 in death benefit was not projected to last as long and Mom & Dad were expected to last and they wanted and needed guidance.

The policy had been put in force as a single pay 1035 exchange in 1999. Just knowing that date you might surmise the new policy was a securities based variable life contract. You would be correct. Unfortunately, too many agents and advisors were chasing stock market returns and in the late nineties it was easy to show attractive alternatives to the existing policies clients had. Generally, these policies were sold under ridiculously aggressive assumptions with no real world modeling or stress testing involved. Additionally, these policies were put in force at the absolute worst possible time for a securities based product, almost immediately before the tech bubble crash, when blind monkeys throwing darts could get attractive double digit returns.

Dad had this idea that he couldn't pay anything into the contracts now and that some day there would be a reappearing and increasing premium due. What he was thinking of was basically the increasing mortality charges of the contract that would be required annually when the cash value ran dry. Who knows where this came from but it was his reality. Furthermore, he had no idea what these numbers would be.

My simple solution was to request multiple new in-force ledgers from the carrier under much more conservative and realistic assumed returns and run to last a variety of durations. We also asked for all of the same at various lower death benefits. All of these scenarios were independently modeled to give them a sense for the chance of success and I calculated the internal rate of return moving forward for each and every scenario so there was an ability to compare apples to apples and to judge what would be an acceptable "deal".

While none of this is particularly complicated or much of an in-depth analysis, it gave the family an immense sense of relief just to know they had at least some control over the destiny of their policy. Before this they were just holding their breath and thinking they were at the mercy of decisions made a couple of decades ago, market returns and what the insurance carrier would "let" them do.

Effectively there has been a meaningful shift in their understanding of what this policy is and how it works, a shift in their realization that they have input control to affect outcome and an ability to understand the results of their decisions in a measurable and comparable format.

This contract and its performance in the big picture may still be somewhat of a disappointment but the outlook and the peace of mind moving forward are a refreshing change of pace.