

Life Insurance Policies are Lapsing: Have You Looked at Your Policy Lately?

When was the last time you pulled that old life insurance contract out of the filing cabinet and read through it? How about reviewing the insurance company's most recent policy statement?

If you are like most people, you haven't done it in years—maybe never. Buying a life insurance policy is hard enough work. Surely you shouldn't need to do anything more than pay the premiums on time and file away any correspondence from the insurance company. Right?

Unfortunately, you're wrong. The burden really is on you to keep an eye on your policy and make sure it's doing what you intended. Each year that passes makes it more likely that there is a big difference between what was projected to happen with your policy and what is actually happening. Most life insurance contracts are *not* performing nearly as well as was anticipated when they were underwritten.

The primary reason (there are others) for underperformance is that insurance companies have been living in the same investment environment as the rest of us. The prolonged period of low interest rates and sub-par performance in the financial markets has taken a toll on "cash value" life insurance contracts. The equity in these contracts is often not growing fast enough to create the funds required to pay the death benefit when the insured reaches old age. Underperforming policies run a serious risk of lapsing before their stated maturity date. This means that, even after all the years you paid premiums, your beneficiaries won't get paid the stated benefits when you die. Or you won't collect the income benefit you were expecting to help you through your golden years.

The problem is particularly acute for consumers who have chosen to reduce the amount of their premium payments, stopped making payments entirely, or have loans on their policies. While traditional life insurance policies do contain some guarantees, they require that stated premiums be paid for the period designated in the contract. If you deviate from that payment schedule, you run the risk of losing the guarantees in your contract.

There is little hard data indicating how many policies are at risk, but it is fair to speculate that a high percentage of life insurance policies are not on schedule to pay a death claim if the insured reaches life expectancy. Consumers are not tuned into this issue, because the professionals who do understand what is happening are reluctant to sound an alarm. Industry insiders hope that increasing interest rates and improved returns in the equity markets will remedy the problem, but we'll have to wait and see.

To better understand what is happening, let's briefly review how life insurance works. Picture the process as a bucket. Premiums you pay are poured into the bucket. Expenses and mortality charges incurred by the insurance company get drawn out of the bucket. Whatever is left in the bucket is invested and earns a return. The goal is to keep the bucket full enough to keep the policy in force for however long the insured is expected to live.

This simple example shows that three basic elements drive performance of a life insurance contract: (1) expenses related to issuing and supporting the policy; (2) mortality charges associated with providing the policy's death benefit; and (3) interest earned on the premiums received by the company.

At the time an insurance company underwrites a life insurance contract, it must make some assumptions about each of these three elements. Based on their assumptions, the company calculates the appropriate premium to charge for the stated death benefit. This process is by no means an exact science. In fact, it is a virtual certainty that the performance of a given policy will not match the printed projection of values that accompanied it when it was purchased.

This would be no big deal if the consumers were well informed and understood how to manage their life insurance. The educated consumer would understand how his policy operates and know how to keep it on track. However, most people find life insurance both confusing to purchase and difficult to monitor over time. It is unlikely that the typical consumer will notice when his policy is underperforming or is in need of some kind of adjustment to keep it in force.

So where can you turn for help, if you are concerned about the fate of your life insurance contract? The first and most obvious place to look for help is the agent who wrote the policy. The agent is probably the person most familiar with your policy and its status. Indeed, some agents are very helpful and will review your policy on a regular basis and make recommendations for changes to it so that it will continue to meet your objectives.

Over time, however, it may be impossible to contact the agent who originally sold the policy. He or she may have changed companies, left the industry, moved away, or retired. Some agents who are still around may not be helpful, because they lack the technical expertise necessary to analyze the policy and offer good advice. Still others may not want to suggest changes for fear they will upset you.

The insurance company that issued the policy is not likely to alert you that a problem is looming either. Even when you contact them, some companies make it difficult to receive service. Perhaps the company that issued the policy has merged with another carrier and does not even exist any longer. Other companies (like Portland-based Standard Insurance Company) have sold their life insurance division to another company and they no longer service it. Even the most well run insurance companies tend not to notify policyholders whose contracts are in jeopardy. Sadly, they just don't have the internal systems required to identify which "buckets are dangerously running dry;" i.e., policies that may be failing.

Don't count on the government to intervene and address your concerns either. Insurance is regulated by state insurance departments that are stretched painfully thin by recent budget cuts and fiscal constraints. They lack the resources necessary to both identify problem life insurance contracts and alert consumers.

So, what can you do? Take a deep breath and get started. Contact the company that issued your life insurance policy. If the policy was taken over by another company, call the new company's service center. Request an "in force" ledger for your policy. This will show your policy's current

values and a projection of the values into the future. Make sure you ask that the company to send you several versions: the standard projection assuming “current” factors for expenses, mortality charges and interest rates; and alternative projections with lower assumptions for these factors.

Once you have these projections, try to determine if the policy will remain in force for at least a few years beyond your life expectancy. The illustration should indicate if and when the policy could lapse. Remember that people are living longer today than ever before. You don’t want a life insurance policy that you’ve had for many years to lapse late in your life, because it will be very difficult to reinstate it.

Hopefully, the projections will indicate that your policy is well funded and very likely to remain in force as long as you live. If you think it’s not going to last as long as you do, it’s time to decide if you really need the policy. Step back and review the reasons that prompted you to buy the policy in first place. Are these reasons still relevant today? Or have things changed such that you don’t need the life insurance any longer.

If you don’t, you have several options. You can take advantage of the policy’s non-forfeiture options. These allow you to convert the policy to a new policy with a lower benefit, change the policy to a fixed-term policy with the same benefit, or surrender it for the cash value. If you wish to maximize the value of your contract, you might be able to sell it to a life settlement company and receive more than the cash value. Alternatively, you could make a tax-deductible gift of the policy to a charity.

If you wish to keep the policy, you have a different set of options. They include adding more money to the policy (in the form of premiums), paying off any loans on the policy, and replacing the contract with a new and better policy. It is generally not a good idea to replace a life insurance contract. However, there are circumstances where it is not only appropriate, but clearly the right thing to do. You might consider consulting with a specialist in life insurance such as a Chartered Life Underwriter or Licensed Life Insurance Consultant. You may be required to pay a fee, but in return you will receive unbiased information and objective advice.

Now you know why you should be reviewing your life insurance regularly. The best way to avoid having your policy fail is to keep a close eye on it. Watch how your policy is performing. If it doesn’t look healthy, consider your options and take the steps necessary to achieve your goals.

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