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Pay a Fee for Life Insurance Consulting? Why Would I Do That?

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In the financial services world we are clearly used to paying fees; money management, mortgage transactions, banking, you name it. Life insurance… hold it! Why would I pay a fee for life insurance advice? That's what I have an agent for.

In the life insurance world, the idea of fee-based consulting, though it is slowly gaining traction, is a bit novel. Though tremendous benefit may be attained by way of a sophisticated, methodical, nuanced consulting and management process, it is still met with industry and market skepticism as it's "not the way we've always done it".

Leaning on the dealmaker, who is paid significant up front commissions, for all of the information one needs to make a significant investment into a financial transaction his family and business may be dependent on is a model not accepted in most other fields. Think about:

- A business acquisition: Is the only source of information from the guy who was selling it or the business broker paid to close it? Did the bank waive the need for an appraisal and credit check because everyone seemed nice?
- A real estate transaction: I'm sure you would pass on the environmental study and inspection because the guy selling the property said everything was fine, right?
- A private equity deal: Any doubt you'd did some homework over and above listening to the woman pitching it to you?
- Equipment purchase: Would you shop the market and compare product features and costs? What about references? Dealer reputation? Service contracts?

Is the insanity starting to show? In reality, people spend more time looking at a Yelp review of a restaurant or an Amazon review of beach chairs than they do digging into the details of a life insurance contract. You know I'm not being facetious. A good agent can be priceless but that shouldn't always be the end of the vetting.

Let's look at a typical money management situation to put this into perspective. You hand $500,000 to a money manager to invest and we assume an 8% return over 30 years. At those assumptions, the value will grow to $5,000,000. I'll assume a 100 basis point gross management fee. Over 30 years the fees total over $600,000, more than the initial investment. However, that is assuming one pays the fees out of pocket, which almost no one does. It's much easier to take the fees out of the pot so no one feels them.

If the 100 basis points were taken out of the investment, the total in 30 years wouldn't be $5,000,000, it would be $3,800,000. This means the fees are really $1,200,000 which is 240% of your investment, about a quarter of your target and almost a third of the $3,800,000 net.

That's a lot of money. But at least you're not writing checks so it's not slapping you in the face. Be honest, would you write a check for an average of $40,000 a year for the next three decades to manage a $500,000 investment?

What about life insurance? Let's look at a $5,000,000 life insurance policy which is arguably much more of a black box. Purportedly that $5,000,000 policy was put in force for something important; estate tax liquidity, family support, business transition, charitable purposes, etc. How many people pay a third party expert for life insurance advice? Not many! And I'm not talking about your attorney or accountant, who may be very smart and effective but likely aren't life insurance experts.

What if you could pay a fee of $5,000, or ten basis points of the death benefit, to manage this policy on an annual basis to assure it will pay a death benefit and your capital commitment is deployed as effectively and efficiently as possible? That is a fraction of investment management fees but I don't see anyone doing it. What if you paid $10,000 only one single time to make sure the policy you put in force has the best chance of accomplishing your goals, has been built as efficiently as possible, has the most advantageous underwriting, has been stress tested and independently modeled, had carrier financials vetted beyond the basic ratings agencies, been subject to an internal fee and cost analysis and flexibility assessment and had the contract actually read from cover to cover to highlight issues and concerns.

I'm just asking "What if?" What if a one-time modest fee could offer this "I'd better get it right because based on how these things work I don't get a do over" transaction the best chance of succeeding over time?

I've dealt with people who won't write a $500 check to make sure a $10,000,000 death benefit will materialize. In fact, I just had an east coast case where the attorney brought me in to get a second set of eyes on transaction where the client was putting $4,000,000 of premium into a $40,000,000 insurance portfolio. When his agent found out and told him he didn't need it, he closed down the $4,000 engagement. If you're doing the math that is a one time, one basis point fee on the death benefit. I'm serious!

I already had all of the information so I did the analysis anyway. Independent modeling showed the policy had a zero percent chance of success (literally, not figuratively). Stress testing showed that a single digit basis point difference in performance versus projections would likely kill the policy and result in no death benefit. Of the $4,000,000 in premium in the first ten years, $2,400,000 of it was gone to policy fees and other expenses and this is before the years of high mortality costs even come into the picture. The total costs over the first 30 years were well in excess of the cumulative premiums (as with the investment example) and by life expectancy the policy charges are over $9,000,000. Ten years after actuarial life expectancy the total charges are now projected at $19,000,000. In other words, the costs of the policy in the 10 years beyond life expectancy (and a meaningful percentage of people will live that long) exceed the first 40 years of the contract. A couple of decades into this cash value based transaction the internal rate of return on premium to cash value was 1 point something percent on the assumption of greater than a 6% consistent crediting rate. Do you now see how important it is to make sure this is done right? Mind you, this is all assuming everything works the way it is "supposed to". If my analysis and the independent modeling is accurate, the expenses will be substantively greater. There isn't any room for error.

Was one bit of this understood? Not a chance. Will he likely lose his $4,000,000 investment and not receive the $40,000,000 death benefit? Statistically and probably yes. Could it have been created to have a high probability of working? Absolutely. But he saved $4,000 so I guess it's all good. Frankly, I feel that if I had charged him $100,000 he would have been more likely to move forward. A $100,000 fee could well have been the best money he could have ever spent regarding a deal like this. Would he pay $100,000 to attorneys, accountants and consultants before putting $4,000,000 down on a $40,000,000 business or real estate transaction?

Why is fee-based life insurance consulting not always popular with the industry? Good consulting can provide significant knowledge. Knowledge is power and that power can be used to one's advantage. The goal of my work is to maximize the benefits for my clients, the consumers. If one believes this is a zero sum game then the other side must see diminished benefits. I feel that is short sighted and win/win deals are possible and best over time. Too often the carrier is seen as an adversary rather than a partner and unfortunately the war stories often back this up.

I realize this all sounds very cynical but if you don't live and breathe this then you cannot understand it. Looking through a few files currently on my desk with ledgers that show the expense pages (pages seldom seen, let alone deeply analyzed) I see fees, charges and expenses which, if shared with policy owners and advisors, might incent them to dig a little deeper into these transactions. In one contract, any premium paid into the policy gets 32% taken right off the top, even many years down the road when the trustee may be trying to shore up an underperforming policy. The 32% premium charge is before contract charges and mortality expenses. Wouldn't anyone want to know this? I'm not trying to insinuate that it is inappropriate and anything can be spun to look terrible but I am blatantly stating that these things need to be understood.

The guy who said no to the $4,000 fee out of pocket is paying many millions of dollars in fees and expenses for a contract with little probability of resulting in anything. It didn't have to be that way. Certainly he has the intellectual capacity to know he is paying fees anyway. One cannot overestimate the emotional impact of paying fees by writing a check versus having them quietly leaked out the back door.

Is it much of a stretch to believe that thoroughly understanding this and being able to control it might be beneficial and transfer some of the power to the policy owners and the advisors? Calculate the internal rate of return on a $4,000 fee to ensure a $40,000,000 payout. It's pretty impressive. It doesn't matter how good a consumer is at what he or she does. Tom Brady throws a football better than I do. My brother-in-law is a better doctor than I could be. Warren Buffet understands investments better and my daughter will always be a better artist. But none of them can tear apart and analyze a life insurance transaction like I can.

In the end, no fee often ends up being the biggest cost. That shouldn't be a surprise. Too often it's pay now or pay later, and later ain't going to be pretty. But at least you don't have to write a check… yet.