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Reviewing a Life Insurance Policy: The Owner as a Pilot

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The role of a pilot is not limited to take-off and landing. Even while flying on autopilot, the pilot still must monitor the flight. The same can be said of the owner of a life insurance policy. The owner must monitor the insurance.

Typically, life insurance is owned by an Irrevocable Life Insurance Trust (ILIT), a revocable trust, or outright by the insured. When owned by an ILIT[1], the death benefit is out of the grantor's estate and thus not subject to either estate tax or income tax. When owned by a revocable trust[2] or owned outright, the death benefit remains inside the estate and, while not subject to income tax, is exposed to estate tax if the estate is larger than the decedent's remaining estate tax exemption[3].

An absurd phrase often used to describe many products in the estate and financial planning world is "set it and forget it". After all, isn't life easier if you can put something in motion and be done with it? We live in a dynamic, ever-changing world, and this world requires – even demands – regular assessments. As it pertains to life insurance, this means that the owner must monitor it. However, what this entails often is misunderstand.

So many variables are at play. What is the "correct" amount of death benefit? How should this amount be determined? How is the amount influenced by life changes or estate growth? What is the estate tax threshold? What is the appropriate type of insurance? What are the differences among the various types of insurance? How should the policy be structured? What is the appropriate way to fund the insurance? From which insurance carrier? Are all insurance carriers the same? The list of questions goes on and on.

The purpose of this article is not to analyze the initial purchase. Rather, it assumes life insurance was already purchased and now must be monitored and maintained. To follow is a list of 10 questions to ask annually:

10 QUESTIONS TO ASK

1. OBJECTIVES: What is the amount of the death benefit, and does this amount still satisfy the insured's needs and objectives?
2. TEMPORARY OR PERMANENT: Is the policy temporary/term or permanent insurance, and is this type most appropriate for the situation?

3. FLEXIBILITY: If term insurance, is the policy convertible to permanent insurance, and what are the conversion restrictions?
4. PERMANENT TYPE: If permanent insurance, what type of permanent insurance?[4]
5. PERFORMANCE: If permanent insurance, is the policy performing as expected, based on the original illustration?[5]
6. FUNDING: If permanent insurance, is the policy being funded sufficiently to make sure it remains in force for the life/lives of the insured(s)?
7. GUARANTEES[6]: If permanent insurance, what are the terms of the guarantees, and are these terms being satisfied?
8. EFFICIENCY: Does a newer, more efficient insurance product exist?
9. CARRIER'S HEALTH: Is the insurance company financially strong?
10. INSURED'S HEALTH: Has the insured's health changed, enabling the insured to qualify for an improved rating class?

Certainly, take-off and landing are the most critical times during a flight. However, by no means does the pilot simply go on autopilot and disregard the phase between the beginning and end. Regular monitoring is critical. Similarly, the owner of life insurance must regularly monitor the policy. Often, the emphasis is placed on obtaining the policy, which is like the take-off, and administering the estate upon the death of the insured, which is like the landing. However, the owner has a responsibility not to operate on autopilot. The owner has a responsibility to monitor the life insurance.

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[1] When owned by an ILIT, the process is relatively simple: draft and execute the trust, fund the trust, have the trustee purchase a life insurance policy on behalf of the trust, and have the grantor continue to fund the trusts with sufficient gifts for the trustee to pay the premiums necessary to sustain the life insurance policy.
[2] When owned by a revocable trust, the process is extremely simple: draft and execute the trust, obtain a life insurance policy, fund the necessary premiums directly to the insurance company with an amount necessary to sustain the life insurance policy.
[3] For 2018, the exemption is $5.6 million per individual, an indexed increase from $5.49 million in 2017. As such, an individual can leave $5.6 million to heirs without triggering a federal estate or gift tax.
[4] Those types generally considered "permanent" include whole life, universal life, variable universal life, and index universal life. However, not all of these are permanent, in the sense that they are guaranteed to last until the death of the insured. Moreover, even those that are structured to last until death occurs might have strict stipulations required to follow in order to maintain the guarantees. The details MUST be understood and satisfied.
[5] Each year, the trustee should request "in-force illustrations" to identify how the policy performs under multiple crediting scenarios and multiple funding scenarios.
[6] Guarantees are based on the claims-paying ability of the issuing insurance company and payment of any required premiums.

ABOUT THE AUTHOR

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