

# Life Insurance Stress Test: Assessing Your Clients' Corporate Owned Insurance

By Vernon W. Holleman, III

With the intersection of recent stock-market declines and volatility, the 2006 Pension Protection Act (PPA), the implementation of the 2001 mortality table, and the prolonged recession, it is an important time to proactively review your client's corporate life insurance programs. You might be thinking – *now* – that should have been done six months ago! No argument, but many corporations simply have had more pressing priorities and have not sat down to examine the benefit programs they have been funding with life insurance. Be sure, however, that this has been on the minds of your clients. Furthermore, for non-client companies, if their existing advisor has not called on them, now is the perfect opportunity to prove your value.

But today, CFOs, HR heads, and benefit managers are coming out of the aforementioned not only have an appetite for reviewing their executive benefits and COLI programs, but are anxious to better understand where they are with these programs from four key perspectives: carrier strength, investment returns (read: cash value), internal costs and contract flexibility, and legislation risk. As their trusted advisor, it is

critical that you update them – regardless of their programs – on all four of these areas.

Begin your discussion by listening. What is going on in their business, what changes are they seeing and making? Perhaps your perspective from dealing with many businesses may be of extra value. Remind them that executive benefit programs can help attract, retain, or reward the people most important to a business. What has not changed is the need to grow a business. You have to incent top people to attract and retain them.

After getting a better feel for the company's picture today, provide clients and prospects with an industry update and carrier-strength review. Help your clients understand that the majority of life insurance carriers are in solid financial shape, despite some notable exceptions. Demonstrate specific ratings for the carriers they are with – show all the ratings and know what each means. Don't let the client buy that ratings are meaningless given the sub-prime situation. This is not a comparable situation. Ratings agencies have far more experience examining life insurance companies and making judgments on their soundness; the sub-prime world was new to them.



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Talk openly about what could hinder our industry in the coming months and years. The commercial real estate market and corporate bond market are where our carriers invest, and those markets are not immune to problems. Tell them what you can do today, and keep them informed going forward. They will appreciate this.

Next, put those benefit liability projections and policy cash value numbers associated with a benefit promise on the table. If the insurance is variable life you may want to take a deep breath before you do! Clients want to know exactly where they are today and what the market volatility means for funding their programs going forward, so your

projections are important. Ideally, have your computer ready to run all scenarios they may ask for. Clients today want to see models showing withdrawals and loans, so be prepared with those.

Today, cash is king. Performing real stress tests on these programs and the COLI behind them will allow you help the company understand, with certainty, its cash needs. For example, if its qualified plan has –fallen below PPA funding levels, they may need to fund it, which could limit their ability to fund the non-qualified program(s). Would a change from annual premiums to periodic help? Are there plan changes you could recommend that take the plan from an after-tax funding strategy to a pre-tax? For variable life programs, fund (sub-account) reviews are critical. Have this discussion with your client.

Companies want to understand the flexibility they have in insurance funding arrangements. Are the products they have flexible regarding premium payments or face amount changes? Could a face amount reduction increase policy efficiency by reducing frictional mortality and expense costs? What are the crediting rates or dividend rates from their universal life or whole life contracts? How are those different from a year ago? What are the variable sub-account options they can chose from?

Corporations do want to know that policy death benefits will be there. Remind them that the death benefit aspect of the program is an advantage and a reason they bought in the first place. Furthermore, demonstrate how recent investment losses affect death benefits with respect to long-term benefit funding. Also, your client may want to explore fixed-rate scenarios – today 5 or 6 percent does not look so bad. Ask frank questions about what changes, if any, they envision.

Be prepared to talk about insurance product innovation and cost savings from changes in mortality rates resulting from the 2001 mortality table. Companies are being called on by competitors with products that have lower mortality and expense costs. Be proactive in addressing this, and either demonstrate newer products yourself or show the advantages of the policies currently in force. For example, a newer product could mean the difference between the company being able to maintain the program or not. Are there exit strategies or any redesign alternatives that may be worth exploring? Could redeploying assets to fewer policies improve the performance or efficiency? Can the client surrender underperforming policies and reinvest those proceeds in superior contracts to reduce charges and enhance the plan?

Understand the tax aspects of changing or terminating existing corporate insurance plans, particularly grandfathered split-dollar plans.

Make sure you are aware of legislation, and help your client understand that you are both aware of the potential for adverse legislation *and* are proactively working to lobby on their behalf. For example, in May the revenue-raising provisions of the Obama Administration's proposed budget included an attack on life insurance owned by businesses. These threats are real and may affect not only your clients' programs, but their cash flow.

### **Key Take-Aways:**

- NOW is the time to be proactive when it comes to business-related life insurance.
- Perform COLI stress tests
- Turn a negative situation into potential opportunities