A MATTER OF CHOICE

"TWO ROADS DIVERGED IN A WOOD, AND I—I TOOK THE ONE LESS TRAVELED BY, AND THAT HAS MADE ALL THE DIFFERENCE."
—ROBERT FROST

VALMARK WHITEPAPER

Originally written in 2015, this white paper is perhaps more relevant today than ever before. As we near the end of 2020, we have seen significant pressure on life insurance carriers, causing many to make changes to their inforce policies, some to cease new business altogether, and others to spin-off their insurance operations. Fortunately, other carriers have invested in new systems to improve service, made underwriting faster and less invasive, and developed innovative products for consumers. Along with *purposeful case design*, *underwriting advocacy*, and *ongoing policy monitoring & management*, a core tenet of an insurance experience that is "10X better" than any alternative is *careful company selection*, a timeless theme.

— Larry Rybka

TAKING THE ROAD LESS TRAVELED

EXECUTIVE SUMMARY: The choices we make in life and in business often have a lasting impact and at times, we are forced to either jump on the bandwagon or take the road less traveled. When it comes to life insurance, we have chosen to take the road less traveled. As independent life insurance professionals, we have the choice of representing almost every carrier and product in the industry; however, we have found that to be an expert at everything is to be an expert at nothing. Therefore, we have chosen to represent only a select number of carriers and products that will bring the best value to our clients.

Many insurance agents claim to offer value by bringing virtually any product or carrier to the table. However, what they fail to mention is that they often are not familiar with how the product works, nor do they have experience with the company selling the product. Often, these agents are simply using spreadsheets of illustrated premiums (numbers on a page) to pitch products that they have never sold and inherently do not understand. This approach has inevitably led to unmet consumer expectations and, consequently, a bad reputation for the life insurance industry.

By contrast, the best insurance professionals understand that life insurance, at its core, is a symbiotic commitment made by an insurance carrier to a policyholder to provide a benefit in the future based on a promise it is making today (a promise that in many cases must last 30 or more years). With a promise this far out in the future and one that has so much riding on it, the best insurance professionals understand there is more to this crucial decision than just price.

INSURANCE EXPERTS ADD LASTING VALUE TO THEIR CLIENTS' DECISION-MAKING BY:

1) Documenting written guidelines utilizing an "Insurance Policy Management Statement" for the selection of carriers and products that are in alignment with the client's stated goals.
2) Advocating for clients throughout the underwriting process by "humanizing" their medical profile and negotiating the best possible underwriting class to keep costs of insurance low.
3) Recommending efficient strategies for policy ownership and structure that minimize taxes without creating undue tax and audit risks.
4) Regularly reconciling actual policy performance with original policy design to maximize its performance and ensure it effectively fulfills its intended purpose.
5) Recommending companies where there is a demonstrably high level of confidence that the companies will deliver on their promises to policyholders.

We have made the conscious decision to avoid the bandwagon approach because, quite simply, we feel that our ethical duty prevents us from purporting to represent every company and every product. Therefore, we choose to represent a portfolio of life insurance products from financially sound carriers that are committed to bringing long-term value to our clients. This choice helps us provide better, more insightful advice and guidance regarding life insurance, while enhancing our ability to service the policies and optimize the effectiveness of our clients' insurance coverage.

THIS WHITE PAPER OUTLINES OUR PROCESS FOR CHOOSING THE COMPANIES WE WORK WITH AS WELL AS OUR REASONING FOR TAKING THE ROAD LESS TRAVELED.

The following discussion is organized into two sections: (I) Why We Choose to Filter Insurance Carriers; and (II) Sample Filtering Criteria

I. WHY WE CHOOSE TO FILTER INSURANCE CARRIERS

THE WORLD IS TOO BIG

In 1980, there were 1,823 life insurers doing business in the U.S., of which 26% were mutual companies and 74% were stock companies. At the end of 2010, there were 917 life insurers doing business in the United States.[1] This number includes every conceivable type of product, and every imaginable type of carrier, including unions, fraternal organizations, reinsurance companies and more. Not only is it impractical for agents to represent every carrier and/or product, it is a mistake to assume that every carrier and/or product is suitable to the unique needs of high net worth individuals and families.

Depending on the specific product being considered, there are roughly 40 carriers in the industry that offer products suited to high net worth clients. Of those 40 carriers, 25 were responsible for 77% of all life insurance acquired in 2010.[2] This means that by solely using objective data, roughly 95% of the carriers in the United States can be eliminated as suitable for high net worth clientele. Our expertise come s in evaluating and reevaluating the remaining 5% to determine which carriers are best aligned to meet the unique needs and objectives of our clients.

PRODUCTS ARE COMPLEX AND CHANGE FREQUENTLY

Most brand name carriers offer products that generally fall into four basic categories: term, whole life, universal life, and variable life. However, within these four general categories, are also numerous sub-categories. For instance, under the umbrella of universal life (UL) there is current assumption UL, guaranteed UL, and indexed UL. Each of the products within the sub-categories has different structures depending upon whether the client's objective is cash value accumulation or the lowest premium for the greatest death benefit. For each carrier there may be as many as 8–20 distinct products that all function differently and are tailored to specific objectives.

Twenty-five years ago, products had an average shelf life of 6-10 years. Today, that rate has increased, and product life cycles are generally around 2–3 years. Advances in technology have greatly increased the pace at which carriers can change products and features to achieve competitive advantages within niche markets. For example, in 2012, one type of life insurance product underwent over 100 announced changes across a handful of carriers ranging from pricing changes to rider eliminations.

As you can see, the complexity of today's product structures coupled with the frequent changes to product features, assumptions, and contractual guarantees make it very difficult to navigate the product landscape. That is why we have chosen to offer an optimized product portfolio that has been properly stress-tested, researched, and dissected. We believe that a true life insurance professional should not only be equipped to explain how a product works, but also how it will respond to a variety of changes in client circumstances, contractual guarantees, and the economy.

AVOIDING CONFLICTS OF INTEREST

We partner with insurers that allow us to represent the client first. Some carrier contracts constrain objectivity or present conflicts of interest that may negatively impact clients. For instance, some carriers require agents to be employees or to use specific broker dealers to sell variable products; others place minimum sales requirements on certain products and offer incentive arrangements tied to production.

Through our relationship with Valmark Securities, our firm is able to leverage the collective buying power of 116 like-minded firms with over $45 billion of life insurance in-force to avoid those minimum sales requirements and restrictions. Furthermore, our status as an independent firm prohibits us from receiving production incentives from carriers, which means that we work for no one else but you.

RELATIONSHIPS REALLY DO MATTER

There are many aspects of the life insurance acquisition process and the post-implementation policy management that are "part art and part science". Relationships often play a key role in achieving acceptable results for clients when it comes to underwriting negotiations, product research, and policy service matters. Strong carrier relationships founded on mutual respect and a reputation for doing the right thing permits us to have direct access to top-level management and key individuals that may significantly influence the outcome of a case. Choosing to represent a select group of carriers allows us to nurture those relationships over time for the benefit of our clients.

THE INDUSTRY IS CONSTANTLY EVOLVING

The economic environment has changed dramatically over the past 30 years. Changes in tax laws, regulatory guidance, and actuarial assumptions have created a challenging environment in which to advise clients. Sometimes the effect of a change today may not be evident for years to come. For example, the governing body of insurance companies, the National Association of Insurance Commissioners, voted to change the accounting standards by which they reserve for liabilities. These accounting changes will be implemented over time meaning that their cumulative effects on carrier financial strength, product pricing, and product availability will remain unknown for quite some time. Another change that is a cause for concern in the industry is the purchase of smaller life insurance companies by private equity firms that have no prior involvement with the life insurance industry. This begs the question of whether these private equity firms are committed to entering the insurance industry or just interested in turning a profit. The implications on existing policyholders have yet to be seen and will likely be dictated by the answer to the previous question.

By keeping a pulse on these and other key issues affecting policyholders, we are in a position to quickly adapt to change and advocate for client rights. At the outset of every client relationship, we put this commitment to service and advocacy in writing and remain in close communication with our clients as changes occur.

II. SAMPLE FILTERING CRITERA

1) ASSESSING CARRIER FINANCIAL STRENGTH

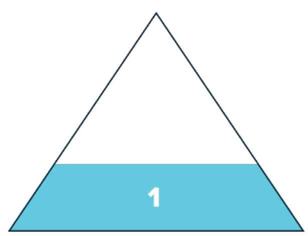
The selection of a life insurance contract represents a financial transaction that typically spans one or more generations. Therefore, choosing a company that will be in business 30–60 years from now is a critical step in case design and consequently, is our first step in the process for identifying which carriers we recommend to clients.

We have found that there is no single source of information that can provide every necessary insight into carrier financial strength.[3] Nevertheless, many in our industry have for years, exclusively relied on rating agency evaluations as a predictor of financial strength. In 2008 and 2009, it became apparent that this approach was flawed as many carriers experienced significant financial troubles, some falling into receivership only to have the government bail them out.

For this reason, we have developed our own system for analyzing carrier financial strength called the STAR (Strength Tracking and Assessment Report) Ranking System™. As part of our STAR Ranking System™, we gather a vast amount of data from several resources including rating agencies, stock analysts, news outlets, and various independent research organizations. We then assess this objective data in light of the economic environment, accounting practices, and regulatory issues to develop a comprehensive financial picture of the carrier.

Once our data analysis is complete, we rank the carriers according to their claims paying ability and repeat the process quarterly as new financial data is released.

STEP 1 – FINANCIAL STRENGTH



2) ANALYZING PAST PRACTICES

The best indicator of future behavior is past practices. The economic turmoil in 2008 brought to light many unscrupulous carrier practices and even caused some of the largest carrier failures the industry has ever known. As Warren Buffet astutely observed, *"Only when the tide goes out do you discover who's been swimming naked"*. Since 2008, carriers have been forced to abandon product lines, sell off blocks of business, dramatically curtail product features, and relinquish entire geographical markets to correct past practices. A 2012 Towers Watson survey of life insurance CFOs indicated that nearly 40% of carriers have either exited product lines or plan to do so within the next six months.[4]

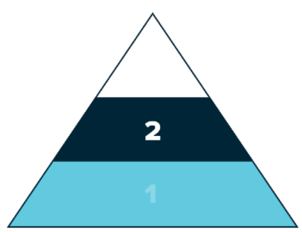
Why the change in commitment? What will happen long-term with expense and earnings elements, which the carrier can change over time (e.g., dividends, policy expenses, interest crediting, caps, participation rates, etc.) and the levels of capital deployed to deliver the promises in the future? With no new sales to support profitability, the closed block alone must be the sole source of income. This is a recipe for disaster.

Here are some recent examples that have occurred just over the past few years:

- After over two decades in rehabilitation by a state appointed body, Executive Life of New York announced immediate corrective action be taken due to excessive liabilities. Other life insurance companies in New York contributed $700 million to help meet state guaranty minimum protection levels for policyholders of the failed ELNY. Despite other companies stepping in to help, 16% of disabled policyholders stand to have their structured settlement benefits reduced, some by as much as 50%.[5]
- Jackson National announced it was exiting the life insurance business in 2012.[6]
- Hartford announced plans to exit the life and annuity business and later announced the sale of their life insurance subsidiary to Prudential in order to focus on other lines of business.[7]
- Aviva announced plans to close or sell a quarter of its business units worldwide due to under-performance. They later confirmed discussions to sell their U.S. business to a private equity group at a $3.6 billion discount to book value.[8]
- New York Life introduced a guaranteed UL product and then ceased new sales of this very product to the brokerage market within a matter of months due to mispricing concerns.[9]
- Sun Life abruptly exited the U.S. life market in 2011 and announced the sale of a closed block of business to a private equity group in 2012. Th e closed block affects holders of annuities and variable life as well as corporate- and bank-owned policies.[10]
- ING's bailout agreement with the Dutch government in 2008 required the insurer to exit the U.S. life insurance business by 2014. However, before the deadline, the divestment program was extended and an IPO was filed for the U.S. business. A final resolution of the matter is still largely unknown.[11]
- Equitable restructured its product portfolio to exit the Guaranteed UL market and to remove long duration guarantees from its product portfolio.[12]

Andrew Carnegie once said, "As I grow older, I pay less attention to what men say. I just watch what they do". True professionals work with companies that walk the walk, not just talk the talk. When choosing which insurance companies we will recommend to our clients, we look f or a demonstrated commitment to policy-holders over time. In the end, a guarantee is only as good as the company that makes it.

STEP 2 – PAST PRACTICES



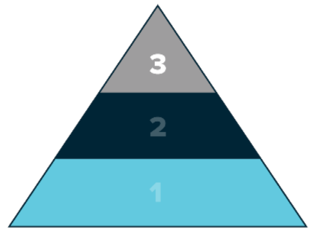
3) SELECTING COMPANIES WITH A PRODUCT PORTFOLIO SUITED TO THE HIGH NET WORTH MARKETPLACE

clients in the high net worth marketplace have unique needs and accordingly often require unique solutions. While there are many product options available, relatively few insurance carriers offer a comprehensive portfolio of products and corresponding custom riders that can be added to base contracts in order to solve certain challenges faced in the high net worth market.

In addition, many carriers cannot offer their products in large enough death benefit amounts to serve the high net worth market due to inadequate capital, underwriting and reinsurance limitations, or lack of desire and feasibility to manage such large financial risks. Finally, many insurance companies do not allow or support the kind of ownership and funding structures that many high net worth clients require in their sophisticated financial, business, and estate plans.

Choosing companies that specialize in servicing the high net worth market is the final, key filter we use in the carrier selection process.

STEP 3 – PRODUCTS SUITED TO THE HNW MARKETPLACE



CONCLUSION: YOUR CHOICE MATTERS

This paper provides an introduction to the reasons why filtering insurance carriers matter and shares a few examples of how the carrier filtering process should take place in practice. A comprehensive analysis on the processes and tools used to appropriately and adequately filter insurance companies should be discussed with your insurance professional.

In the end, the decision to purchase life insurance is perhaps one of the most important decisions many people will ever make. The benefits of a life insurance policy are often decided on and funded today, yet they are predicated on a promise being honor ed by an insurance carrier 10, 20, 50 or more years in the future. With this in mind, it stands to reason that choosing which insurance carrier to partner with is equally as important as the decision to buy life insurance itself.

A decision this important comes down to choices. We have made the choice to vigilantly and diligently filter through the immense universe of life insurance carriers to select those partners we believe are in the best position to honor and protect the promises in the future that they make to our clients today.

However, your choice matters too. You can choose who represents you in life insurance matters. You can choose to work with a life insurance agent who claims to represent the entire universe of carriers and products, or you can choose to work with a true insurance professional who has a process for selecting long-term carrier partners and adds real value to the life insurance decision-making process.

The choice is up to you. We invite you to work with us and we are confident that you will be pleased with your decision for many years to come.

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[1] 2011 Life Insurers Fact Book. American Council of Life Insurers (ACLI).

[2] Ibid.

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