WINGED KEEL GROUP®

Winged Keel Group Insights

COVID-19: Life Insurance Market Update

Winged Keel Group Insights is a publication designed to create education and awareness around life insurance topics and solutions that may address certain needs of your clients and their multidisciplinary goals.

What Policyowners Can Do to Optimize Coverage in This Rapidly Changing Environment

As we are all currently experiencing, there are some significant challenges created by COVID-19 for our society and its economy, and these challenges also affect life insurance companies. COVID-19 is having a profound impact on life insurance policies in three areas: existing product performance, new product pricing, and medical underwriting.

Many of the challenges for life insurance companies stem from the general interest rate environment. After a sustained period of low interest rates, the action of the Federal Reserve during March—which brought the short-term rate to 0–25 basis points—further strains the insurance companies' abilities to generate returns from their general account portfolios. It is this interest rate environment, rather than the mortality impact of the virus, that challenges insurers' ability to offer products that can generate reasonable expected profits for them without making some modifications.

Impact on Existing and New Life Insurance Policies

As a result of lowered interest rates to support the economy during the COVID-19 pandemic, there are likely to be impacts to existing and new non-guaranteed policies. Insurers are reviewing their in-force product portfolios to assess if changes are required to policies supported substantially by investment grade fixed-income securities. The following are policy types that clients should review to determine whether there are changes affecting their performance.

Guaranteed Universal Life (GUL): Notably, existing GUL policies will <u>not</u> have any changes to their guaranteed premiums and guaranteed insurance benefits. However, due to lowered interest rates, many insurance companies are actively repricing <u>new</u> GUL policies. This repricing action will take some time to implement, and increases will be in the range of 5-10%. Similarly, some insurance companies are repricing Term Insurance products, particularly the longer duration products (e.g., 30-Year Term Insurance).

Whole Life (WL): The account value of these policies is credited with a dividend. Dividend crediting rates are largely supported by the insurer's general account investments, of which typically 80–90% are investment grade fixed-income securities. These rates are declared annually, and we expect they will be lowered given the interest rate environment. In addition, as insurance companies look to maintain the profitability of these products, they may begin to increase the non-guaranteed charges within the contracts. These changes impact the illustrated cash value, illustrated insurance benefits, and projected premiums.

Fixed Universal Life (UL): The account value of these policies is credited with interest. Interest crediting rates are largely supported by the insurer's aforementioned general account investments. Insurance companies are actively assessing, and reducing, these interest crediting rates. Similarly to Whole Life, these policy contracts also have non-guaranteed charges that may be increased, and such adjustments will have a negative impact on illustrated policy performance.

Indexed Universal Life (IUL): The account value of these policies is credited by reference to an index, such as the S&P 500 Index, without dividends, subject to a floor and a cap (e.g., a floor of 0% and a cap of 9%). Insurance companies have complete discretion to adjust the cap on the index. In most contracts, the guaranteed cap rate is only 3%.

We have already seen numerous insurance companies take action to reduce the cap rate by 50-100 basis points. One of the keys to IUL is to capture as much upside performance in the periods that the S&P has high returns. By reducing the cap, the long-term performance of these products is significantly affected.

These policies are still supported by the insurer's general account investments and impacted by the cost of options needed to hedge the non-guaranteed floor and cap rates of the index account. They also have non-guaranteed charges that the insurance company may look to adjust.

Clients who have used third-party financing to pay premiums on these contracts (there is a significant amount of this in the market) should pay specific attention to the renewal terms of the loans and how the cap-rate reduction is illustrated to affect the long-term performance of the structure.

Variable Universal Life: Credits to the account value of these polices are based on the earnings or losses of underlying investments in selected registered funds (e.g., mutual and index funds).

Given the extreme volatility in the stock and bond markets, clients should review these policies to ascertain if a significant diminution in account value has occurred that affects policy duration or required premiums. In addition, the asset allocation of the policy should be reviewed to determine if rebalancing is needed.

While these policies have certain non-guaranteed charges as well, we believe significant changes to the contract charges are less likely because these policies do not create the same strain that WL, UL, and IUL have on the balance sheets of insurance companies.

Impact on Underwriting New Policies

In addition to managing the impact of the interest rate environment on their existing and new product portfolios, insurance companies have taken steps to manage their mortality risk pools. Insurance companies are temporarily declining to consider, restricting, or delaying new coverage for certain people that could have greater risks of COVID-19 complications.

Some examples of these protective measures include: temporarily not offering coverage to people over a certain age (typically 70 or 80 years-old); restricting coverage amounts for people over age 60; delaying coverage for people who have traveled to certain countries or that live in so-called "hotspots"; delaying coverage on people with respiratory or other COVID-19 high-risk conditions; requiring additional statements of good health prior to issuing policies; and imposing temporary reinsurance limitations.

The medical underwriting process for acquiring new life insurance has been challenged by the current environment as well. While insurance physicals can still be completed in many regions, there is a temporary pause in some areas like New York City in an effort to protect the safety of clients and the examiner. The collection of medical records is also significantly delayed in the current environment.

As challenges emerge, so do opportunities for evolution and enhancement. Many insurance companies are evolving their current medical underwriting process to accommodate clients during this time.

For instance, insurers are developing guidelines that will allow them to issue new life insurance policies without requiring a new insurance physical, recognizing that during COVID-19 many insureds will not be able to complete an insurance physical. If the insured has had a thorough annual physical from his or her personal physician in the past 12-24 months, insurance companies are considering accepting this in lieu of an insurance physical.

Other insurance companies are allowing individuals' personal physicians to complete the medical exams rather than an exam company contracted by the insurance company. Insurers are also accepting, for the first time, electronic health records. Additionally, there has been an expansion of accelerated underwriting programs for specific low-risk demographics that require no medical records or lab samples.

The other element that we believe will have long-lasting positive effects is that many insurance companies are now accepting DocuSign rather than wet signatures. The industry has been woefully slow in adopting electronic signatures, and we are thankful insurers have evolved their processes to be responsive to market conditions.

We, along with other industry experts, are hopeful that these evolutions will lead to positive long-term changes to streamline the medical underwriting and application processes.

Actionable Steps to Consider Now

We recommend the following considerations when advising your clients on their life insurance portfolios:

- ✓ Conduct a comprehensive review of your life insurance policies. Policy reviews with new in-force illustrations will help determine the effects on performance and required premiums, whether ownership and beneficiary designations are optimal, and whether coverage amounts remain correct for your client's circumstances.

- ✓ Understand the effects of lower dividend crediting rates on WL policies. Insurance companies issuing WL policies are likely to reduce these crediting rates even further given the recent action taken by the Federal Reserve and the anticipated interest rate environment going forward. Rate reductions to compensate for current bond yields are expected and may affect the long-term performance of these policies.

- ✓ Carefully analyze the effects of changes to floor and cap rates associated with IUL policies. Rate reductions to compensate for current market volatility are likely and may affect the long-term performance of these policies.

- ✓ Explore the refinancing opportunities of AFR and Split Dollar loans related to life insurance policies. With historically low AFR rates, opportunities or improvements exist for all types of estate planning techniques, such as: Split Dollar loans, intra-family loans, GRATs, and discounted asset sales to trusts, among others.

- ✓ Review conversion features on Term Life policies. As a reminder, a conversion feature allows the policy owner to switch from a term to permanent policy without having to qualify medically. With pricing increases imminent, it could be advantageous to convert in a timely fashion.

- ✓ If you are acquiring new coverage now, be sure to explore the entire market. Prior to finalizing a new acquisition, ensure that your insurance advisor has surveyed all insurers and products given the fluidity or quickly changing market we find ourselves in now.

If you would like to explore any of these topics further, your contact at Winged Keel Group would be happy to discuss.

DISCLOSURES

Variable life insurance products are long-term investments and may not be suitable for all investors. An investment in variable life insurance is subject to fluctuating values of the underlying investment options and it entails risk, including the possible loss of principal.

The tax and legal references attached herein are designed to provide accurate and authoritative information with regard to the subject matter covered and are provided with the understanding that Winged Keel Group, Inc. is not engaged in rendering tax, legal, or actuarial services. If tax, legal, or actuarial advice is required, you should consult your accountant, attorney, or actuary. Winged Keel Group, Inc. does not replace those advisors.

Securities offered through M Holdings Securities, a registered broker dealer member FINRA/SIPC. Winged Keel Group is independently owned and operated. By accepting these materials, the recipient agrees to keep the materials and their content confidential and not to use the materials or the content for any purpose other than to evaluate a financial transaction with Winged Keel Group, Inc. of the type described in the materials, except that there is no limitation on disclosure of the tax treatment or tax structure of the products and/or transaction structures contained herein. W4713 #3061246.3