Best Practice Standard for Life Insurance Stewardship

West Point Draft
May 7th, 2013

Produced By:

Leadership Center
for Investment Stewards

Complements of:

Veralytic
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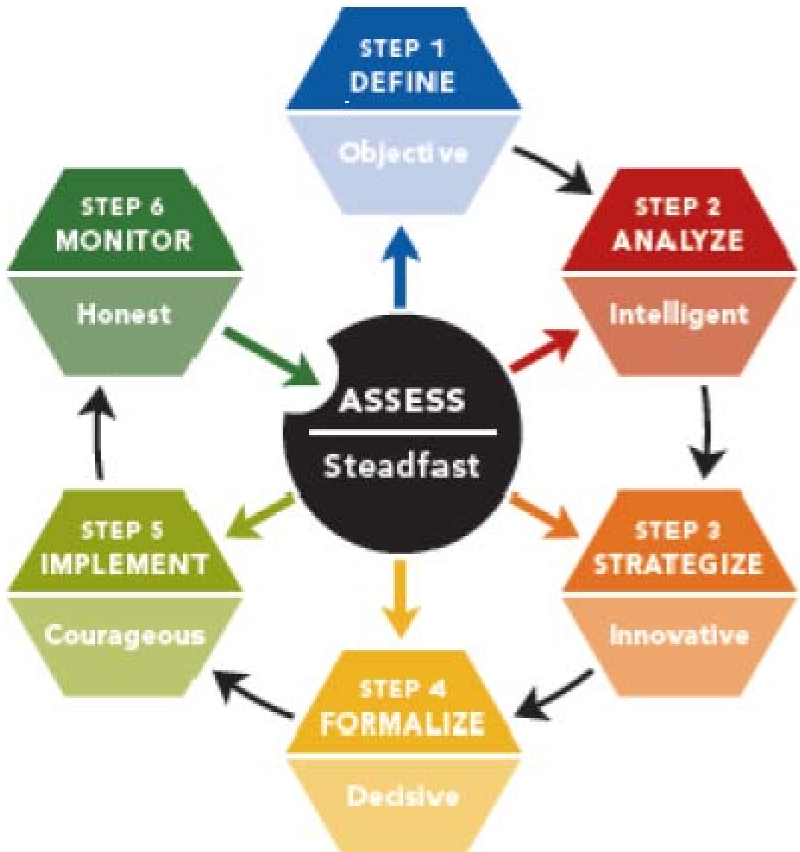
Illustration 1



FOREWORD:

Life insurance is increasingly being promoted and considered as an investment asset. However, it remains the last, largest, most-neglected asset on most clients' balance sheets because wealth managers and fiduciaries and even life insurance brokers have struggled with the MANAGEMENT of life insurance as asset for a variety of reasons, namely:

- Brokers struggle because prevailing industry marketing practices are not consistent with, and in some cases actually violate, the Prudent Investor principals near and dear to wealth managers and fiduciaries,
- Wealth managers and investment advisors struggle because they have not been able to look up the pricing and performance of life insurance products the way they can for most every other type of asset they manage, and
- CPAs, tax attorneys, and particularly trustees struggle because they lacked standards for the prudent selection and proper management of life insurance as an asset like they have and follow for most every other type of asset in their care.

In response, a group of industry leaders gathered at West Point in April 2013 to finalize a Best Practices Standard for Life Insurance Stewardship. In attendance were representatives of nearly every profession who has clients who own life insurance, to include: the largest trust and estates law firm; the largest TPA of TOLI; the largest association of financial planners; a leading financial planning university; and, most of the largest independent distributors of life insurance. These standards apply the same universal decision-making framework to life insurance already widely-accepted in the investment business as depicted in Illustration 1.

The edited standard, which will now be referred to as the “West Point Draft”, will be administered by an Advisory Board overseen by the *Leadership Center for Investment Stewards*, a Swiss-based, not-for-profit professional society. As soon as practical, the *Leadership Center* will publish the West Point Draft and provide the public web-based access to the Standard and the ability to comment on the proposed language.

The catalyst for the Standard was the FPA, which recognized in 2010 the need to develop a standard associated with the delivery of a life insurance proposal to a financial planning or wealth management client. Most of the attention which had been given to standard setting was focused on investment management; there was need for similar rigor for insurance planning.

May 7, 2013

Executive Summary

The first draft of the *Best Practices Standard for Life Insurance Stewards* (Standard) was prepared by a task force consisting of Barry Flagg, Joe Maczuga and Don Tone, and later augmented by Vince Micciche.

The first draft was subsequently reviewed and edited at West Point April 24 – 25, 2013 by the following industry thought leaders:

Paul Auslander	John Gilliam	Vince Micciche
Mike Brohawn	Josh Husbands	Mike Pepe
Mark Chamberlain	Andy Kalinowski	Julie Schneider
Rita Cheng	Brett Lotspeich	Jacqueline Steinberg
Barry Flagg	Joe Maczuga	Don Trone
Mathew Geherin	Jim McGuire	

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The Standard is based on a universal decision-making framework which consists of six Steps and seventeen Dimensions (Dimensions define the details of a Step). A similar framework has been used to develop a:

- ✓ Global wealth management standard for wealth holders;
- ✓ Fiduciary standard for advisors, trustees and investment committee members;
- ✓ Governance standard for directors; and
- ✓ Project management standard for staff.

Step 1 - Define

Dimension 1.1: Define roles and responsibilities of decision-makers

The Life Insurance Steward:

a. Defines the roles and responsibilities of each decision-maker and service provider (party); including:

- Policy owner
- Insured
- Life Insurance Steward
- Related Financial Stewards
- Attorney
- Accountant
- Payor/funding party

b. Confirms that each party demonstrates an awareness of their role and responsibilities
c. Requires a statement from any party who may have a potential conflict-of-interest, and how this conflict will be managed. (Consistent with Dimensions 5.2 and 6.3)

Step 2 – Analyze

Dimension 2.1: State goals and objectives ("objectives")

The Life Insurance Steward defines the client's goals and objectives, in terms of:

a. What the life insurance is for:
   - Asset Protection
   - Business Continuation
   - Family Protection/Income Replacement
   - Estate Planning
   - Investment planning
   - Retirement Planning/Funding
b. Core values, personal and business relationships and/or philanthropic objectives

Dimension 2.2: Brief decision-makers on objectives, standards, policies, and regulations

The Life Insurance Steward:

a. Defines the decision-making framework for all persons serving in a fiduciary capacity (such as the trustee of a life insurance trust)
b. Confers with the client's tax advisor that the life insurance strategy (strategy) is tax compliant
c. Confers with the client's legal counsel to confirm the appropriateness of the legal structure
d. Confirms that the client is eligible to obtain appropriate insurance products
e. Confirms that each party has the capacity to comply with this Standard
f. Confirms that any party lacking expertise has prudently delegated

Step 3 – Strategize

Dimension 3.1: Identify sources and levels of **Risk**

Considering the client's goals and objectives (consistent with Dimension 2.1), the Life Insurance Steward:

a. Defines the client's sources of risk, and capacity of each, in terms of:
   - Loss of income
   - Longevity
   - Disability, long-term health care issues (see also Health Care Planning Standard)
   - Investment risks
   - Business non-continuation
   - Changes in tax code and/or estate planning regulations
   - Family governance issues; family disruption; bad actors in the family
   - Liquidity needs

b. Confers with parties on the client's sources and levels of risk

Dimension 3.2: Identify **Assets**

The Life Insurance Steward defines the client's assets (all assets in summary form, not just those tied to insurance planning), in terms of:

a. Liquid assets
b. Illiquid assets
c. Business assets
d. Anticipated future assets
e. Human capital/earning capacity

Dimension 3.3: Identify **Time Horizons**

The Life Insurance Steward defines the time horizon associated with each stated life insurance goal and objective, taking into consideration such factors as:

a. Definitive short-, intermediate- and long-term time lines or events
b. Contingent short-, intermediate- and long-term time lines or events
c. Duration of coverage

Dimension 3.4: Identify **Expected Outcomes** (“performance”)

The Life Insurance Steward identifies performance objectives for life insurance policies, and for assets invested in insurance policies, in terms of:

a. Absolute returns and outcomes/contractually guaranteed
b. Relative returns and outcomes/non-guaranteed assumptions
c. Stability of the product's pricing
d. Funding objectives
e. Contingency outcomes
f. Underwriting parameters

Step 4 – Formalize

Dimension 4.1 Define the strategy that is consistent with RATE

The Life Insurance Steward defines the strategy which is consistent with the client’s risk capacity, assets, time horizon and performance expectations, as applicable, taking into consideration:

a. Non-insurance strategies, including the diversification of carriers
b. Self-insurance strategies
c. Use of existing policy(s)
d. New insurance strategies

In the case of 4.1.c. and 4.1.d. above, the Life Insurance Steward should consider:

e. Policy style and functionality with regard to an understanding of:
    - Premium dependence
    - Cash value dependence
    - Risk assumed by each party
    - Responsibilities assumed by each party

Dimension 4.2: Ensure the strategy is consistent with implementation and monitoring constraints

The Life Insurance Steward ensures that the life insurance strategy:

a. Is not constrained by the Steward's:
    - Compensation model
    - Distribution structure, or agency relationships
    - Use of proprietary product

b. Is not constrained by:
    - Prevailing industry marketing practices
      [To illustrate, from the Society of Actuaries Final Report of the Task Force for Research on Life Insurance Sales Illustrations: “Illustrations should not be used for comparative policy performance proposes” because doing so is “fundamentally inappropriate.”]
    - Insufficient underwriting offers
c. Is consistent with prevailing industry best practices when such practices are not in conflict with this standard
      [To illustrate, FINRA Rule 2210 states: “It is inappropriate to compare a… life insurance policy with another product based on hypothetical performance…” because such comparisons can be “misleading” and are “strictly prohibited.”]

Dimension 4.3: Formalize the strategy in detail and communicate

The Life Insurance Steward prepares a written Life Insurance Strategy Statement (LISS), which at a minimum, identifies:

a. Policy owner (client)
b. Insured
c. The legal structure of the policy owner if other than an individual.
d. The roles and responsibilities of each party
e. As it relates to the life insurance product(s), the client's risks, assets, time horizons, and expected outcomes (consistent with Dimensions 3.1 - 3.4)
f. The due diligence criteria for the selection of the life insurance product(s) (consistent with Dimension 5.1)
g. The monitoring criteria for the life insurance strategy (consistent with Dimension 6.1)
h. The process for controlling and accounting for fees and expenses associated with the life insurance strategy (consistent with Dimension 6.2)
i. Real or potential conflicts of interests (consistent with Dimension 6.3)
j. Rate class of the insured

Step 5 - Implement

Dimension 5.1: Define the process for selecting key personnel to implement the strategy

The Life Insurance Steward develops a due diligence process for selecting product(s) which includes, as a minimum:

a. The type of life insurance company
b. Its distribution channel
c. Its financial strength and claims-paying ability rating
d. Its retention limits

e. Its underwriting capabilities
f. It's reputation for client service, clarity in client communication, and integrity
g. Contractual provisions that allow for maximum control and flexibility and liquidity
h. Transparency of fees and expenses; including:
    - Cost of Insurance Charges
    - Fixed Administration Charges
    - Premium Loads
    - Cash-Value-Based "Wrap Fees" (e.g. VUL, M&Es)
    - Surrender/Early Termination Charges
    - Fund Management Fees (FMEs)
i. Performance of invested assets underlying policy cash values, including:
    - Availability of investment options
    - Tenure of portfolio management team
    - Style or peer group consistency
    - Assets under management
    - Performance relative to peer group
    - Risk-adjusted performance relative to peer group
    - Fund fees and expenses
    - Contractual provisions
j. Competitiveness of product pricing and performance within its peer group
k. Liquidity

Dimension 5.2: Define the process for selecting tools, methodologies, and budgets to implement the strategy

The Life Insurance Steward defines a process for:

a. The selection of the appropriate product(s):
    - Term
    - Universal
    - Variable
    - Whole Life
    - Single, Joint
b. Ensuring the sustainability/ continuation of the policy, considering, as a minimum:
    - Lapse Risk
    - Liquidity Risk
    - Default Risk
    - Systemic Risk (the risk that a financial crisis could impair the ability of an otherwise adequately capitalized insurer to pay a death claim)
c. Reducing expenses through the blending of strategies (conversion of existing policies)
d. Pricing consideration of the secondary market.

Dimension 5.3: Ensure that service agreements and contracts do not contain provisions that conflict with objectives

a. The Life Insurance Steward ensures that service agreements and contracts do not contain provisions that conflict with the goals and objectives of the client
b. Contracts reflect representations made by product provider(s).

Step 6 - Monitor

[Editorial note: As used in this Standard, the frequency of "periodic" is dependent on type of product(s) utilized with the client's strategy.]

6.1: Prepare periodic reports that compare performance with objectives

The Life Insurance Steward defines a process to periodically monitor the life insurance strategy which includes, as a minimum:

a. Changes to the client's sources and levels of risk capacity, assets, time horizons, or performance expectations
b. Changes to the insured's health
c. Financial stability and rating of the product provider
d. Funding adequacy (over-funded/underfunded) of the insurance strategy; taking into consideration:
    - Increasing/decreasing the planned premium
    - Increasing/decreasing policy benefits
    - Rebalancing the asset allocation of the underlying investment strategy (cash value products)
    - Changing policy contracts
    - Changing coverage duration
e. The review of product costs and expenses relative to the original proposal(s) and representative benchmark averages
f. Changes in tax and/or estate planning laws
g. Changes in beneficiary designations
h. Alternatives for a policy once a risk has been reduced or eliminated.

Dimension 6.2: Prepare periodic reports that analyze costs, or ROI, with performance and objectives

The Life Insurance Steward:

a. Periodically analyzes fees and expenses associated with the life insurance strategy, including:

- Fees paid to third party administrators, trustees, and insurance consultants;
- Brokerage costs, and use of soft dollars; and
- Fees and expenses of service providers.

b. Analyzes the impact fees and expenses have on the product, seeking to minimize cost and maximize capital efficiencies.

Dimension 6.3: Conduct periodic examinations for conflicts-of-interest and self-dealing, and breaches of a code of conduct

The Life Insurance Steward:

a. Conducts periodic reviews of all parties to ensure that there are no new conflicts (consistent with Dimension 5.2) which may conflict with the client's strategy
b. Defines (or refers to) an ethics code or standards statement, and ensures that all parties periodically acknowledge the same
c. Remains objective and promotes a policy of full disclosure
i. Advises the client when conflicts arise and how such conflicts will be managed

Dimension 6.4: Prepare periodic qualitative reviews or performance reviews of decision-makers

The Life Insurance Steward:

a. Conducts periodic qualitative reviews of all service providers to determine whether there are personnel or organizational changes which may impact the quality of services being provided to the client; and
b. Takes into consideration any legal or regulatory charges brought against a service provider.

About Leadership Center for Investment Stewards:

Headquartered in Mystic, CT, the Leadership Center for Investment Stewards inspires responsible investment stewardship by developing standards of conduct, engaging in topical research and delivering training programs which are grounded in moral, ethical and prudent decision-making. The Leadership Center's most noted activity is its Leadership Boot Camp for Investment Stewards which is conducted at West Point.

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About Veralytic:

Veralytic is an independent life insurance research company based in Tampa, Florida. Veralytic provides objective, innovative research solutions to help our customers reduce costs and risk, improve consistency, and document due diligence processes against possible lawsuits and regulatory requirements. Our clients include agencies, brokerages, independent insurance professionals and trust companies. Our research reports are based upon a patented "five star" rating system that benchmark suitability against an ever growing database. Veralytic has been endorsed by the New York Bankers Association (NYBA), accepted by the Financial Planning Association (FPA), reviewed by the chief regulatory body of the financial services industry, and trusted by dozens of brokerages and agencies across the United States.

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