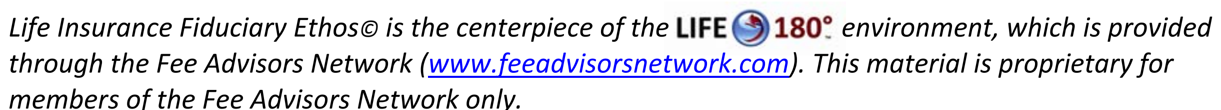
LIFE INSURANCE FIDUCIARY ETHOS©

Life Insurance:

Life insurance is one of the most widely recognized tools of risk management planning. It is a contract between the policy owner and the insurer, where the insurer agrees to pay (1) a designated beneficiary a sum of money upon the occurrence of the insured individuals' death (or, if so provided in the contract, a specified amount upon proof of terminal illness or critical illness; (2) the policy owner an amount equal to the cash surrender value in the contract upon request or at a certain age.

Ethos: The distinguishing leadership characteristics, sentiment, moral nature, guiding beliefs, and decision-making doctrine of a person, group, or institution.

We wish to gratefully acknowledge Donald B. Trone, the author of Fiduciary Ethos©, for his leadership in business ethics. Mr. Trone has graciously granted permission and rights to Joseph W. Maczuga to develop Life Insurance Fiduciary Ethos© based on the framework and principals of Fiduciary Ethos©. Mr. Trone is CEO of Strategic Ethos (www.5ethos.com), founder of the Foundation for Fiduciary Studies and Fiduciary 360, and has authored numerous books on standards of excellence, fiduciary principles, and leadership characteristics.



Life Insurance Fiduciary Ethos© is the centerpiece of the LIFE 180° *environment, which is provided through the Fee Advisors Network (www.feeadvisorsnetwork.com). This material is proprietary for members of the Fee Advisors Network only.*

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Definition of Life Insurance Fiduciary Ethos©

Life Insurance Fiduciary Ethos© is best described as a standard of excellence in the **process** of providing unbiased life insurance analysis and design. The environment in which financial planning is accomplished is of utmost importance; it ultimately impacts whether the client's interest is genuinely given the highest priority. Life Insurance Fiduciary Ethos© defines the framework of a planning environment that is unbiased and adheres to the responsibilities of a true fiduciary.

Life Insurance Fiduciary Ethos© is the centerpiece of LIFE 180°.
LIFE 180° represents a major change; a 180° turn in the risk management component of financial planning. LIFE 180° is the result of a joint-venture between Comprehensive Analytics, Subject Matter Experts and the Fee Advisors Network. It was developed after years of research and experience in providing fiduciary driven insurance analytical and consulting work to Independent RIA's, Wealth Management firms, and Fee-Only Advisors. This comprehensive methodology incorporates a new paradigm of risk management analysis and the use of life insurance and annuities, including: policy style, premium design, strategy integration, facilitation and monitoring.

Life Insurance Fiduciary Ethos© is based on a framework of Principles and Process. These Principles have been established by the Uniform Prudent Investors Act (UPIA) of 1994, and our Process follows the traditional five-step planning process used by fiduciary investment professionals (Analyze, Strategize, Formalize, Implement and Monitor).

To properly execute each step of the five-step process, there are essential characteristic requirements; these are identified in qualities such as: Intelligent, Innovative, Decisive, Courageous and Honest. Also central to the process is an ongoing need to assess performance, align objectives, and make any necessary adjustments.

Definition of Risk Management:

(1) To ascertain exposure of potential loss to assets, hard or soft, including that of human value; financial, emotional, mental, and philosophical;

(2) To analyze impact of loss due to identified risk exposure;

(3) To recommend options to protect against such loss so as to manage the risk within the framework of the client's objectives and the team of advisors involved in order to negate or reduce the impact of loss;

(4) To use **insurance** as a leveraged avenue of protection against identified risk when it has been established as the best cost-benefit solution.

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An Advisor's Standard of Care

There is an important debate occurring in our country at this time. This debate has to do with identifying the best ways to provide protection for consumers who utilize financial products and services. Government and regulatory agencies are compelled to act, but it is unclear which agencies will emerge with authority and a useful set of guidelines that will have meaningful impact. Many question whether a politically controlled agency, highly influenced by lobbying interests, is the most advantageous approach to effectively protecting consumers.

In the midst of the debate over consumer protection, the financial services industry finds itself in a state of confusion and uncertainty. Professional organizations are aggressively lobbying for or against higher standards of care, fiduciary language, and full disclosure. Broker-Dealers are concerned about how potential changes will impact their business model. The insurance industry is staunchly opposed to transparency. Many Registered Investment Advisors who engage in financial planning are becoming increasingly nervous over their potential exposure to fiduciary responsibility that extends beyond that of investment advice.

The desire for consumer protection is further complicated by a growing list of financial service provider brandings. For example, it may be difficult for the consumer to understand the difference between a fee-based planner and a fee-only advisor. What differentiates a financial *planner* from a financial *advisor*? What is a trusted advisor? While these classifications are providing some sense of unique branding among industry competitors, the sheer number and distinctive differences are difficult for the consumer to navigate.

The consumer is further confused by the wide variety of professional certifications and designations offered and pursued by the financial services industry. Certifications and designations should be developed to give the consumer a sense of an advisor's competency, trustworthiness and credibility. There is little evidence that the consumer has benefited from this professional certification and designation frenzy.

In the financial services industry, fiduciary responsibility is frequently associated with responsibilities of the Investment Advisor. The IA may be classified as a broker/agent, a registered representative, a registered investment advisor (RIA), a steward, a trustee, or a fiduciary. The financial services industry finds it difficult to distinguish one role from another; the lines of responsibility are relatively unclear.

Finally, federal and state agencies are increasing regulation based on limited knowledge of the vast problems associated with the consumer-advisor relationship.

This is a brief overview of a problematic, complex state of affairs…and why we have labored to develop a viable solution for risk management: **Life Insurance Fiduciary Ethos©.**

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Roles among Financial Planning Industry Classifications

Insurance Agent – legally obligated to act on behalf of the insurance company and contractually obligated to provide that company's products before others. This classification is primarily true in the relationship of a "captive" agent, one who writes business for one company (or primarily one company) and receives additional operational support for that company for doing so. This is most common with mutual companies. Monetary bonuses and other incentives create external influence to recommend a particular product or product design from that company. There is no requirement for transparency or disclosure.

Insurance Broker – Agents who are licensed with multiple insurance carriers and present themselves as acting on behalf of the client to obtain the most competitive advantage. This classification is primarily true in the relationship of a "non-captive" agent, one who may write business for any of the numerous companies with whom they are licensed. While still obligated to act on behalf of the insurance company, they are not mandated to provide that company's products before every client. Monetary bonuses and other incentives create external influence to recommend a particular company. There is no requirement for transparency or disclosure.

Registered Representative (RR) – Certain life and annuity products are considered to be "equities" in nature, such as the variable life and variable annuity products. Most RR's are referred to as being dually licensed, which means that they are licensed in securities as well as life insurance. All RR's are affiliated with a broker-dealer (B/D). The RR who is a Captive Agent will be affiliated with a B/D that is owned by the insurance company to which they are captive. Whereas most RR's are registered with a B/D that provides multiple companies and products from which the RR can choose. If the RR is recommending a securities related product, there is a higher level of qualifying the client through a process called "Suitability". Also, additional disclosure related to the equity product is presented to the client in the form of a prospectus. RR's may also function as Investment Advisor representative (IAR's), which is further discussed under RIA Differentiation.

These classifications are subject to the following environment:

1) Monetary bonuses and other incentives create external influence to recommend a particular company or product.
2) Production quotas apply pressure as to (a) number of sales that have to be made, or (b) preference of one company over another.
3) Although securities related insurance products do require increased disclosure via the prospectus, the benefits of such disclosure on life products are minimized due to the Point-of-Sales document known as the Illustration (more on this later).
4) There is no requirement for FULL transparency or disclosure, regardless of product or company.

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Registered Investment Advisor - A Registered Investment Advisor (RIA) is a person or firm in the United States who has registered with the U.S. Securities and Exchange Commission or state regulatory agency (where the primary business is situated or multiple States in some cases) in connection with the management of the investments of others. By definition, an RIA is considered to be acting in a fiduciary capacity on behalf of clients, providing a higher standard of due care (to fully disclose, minimize and resolve conflicts of interest) than would be found in a traditional securities brokerage environment. In addition, RIAs are usually compensated on a fee basis (generally as a percentage of assets under management) for securities related activity.

Registered Investment Advisers are given explicit guidelines of compliance in their professional duties. The Investment Advisers Act of 1940 and The Uniform Prudent Investor Act (UPIA), established for the investment and trust industry in 1994, distinguish fiduciary obligation as follows:

- Put the client's best interest first and foremost.
- Act with prudence.
- Provide full and fair disclosure of all material facts.
- Avoid conflicts whenever possible.
- Manage unavoidable conflicts for the benefit of the client.

RIA Differentiation

Our industry has been experiencing a growth of RIA's that fall into two universes. The Independent RIA is one that is not affiliated with a broker-dealer, while all others are affiliated with a broker-dealer. Many broker-dealers have their own RIA firms, which serve as an arm of the B/D. Registered representatives can practice under that firm's RIA umbrella as an Investment Advisor Representative (IAR), allowing them to charge fees for investment advice. In addition, individual RIA's or RIA firms may affiliate themselves with a B/D for any number of reasons. However, in regard to the Risk Management issue, an IAR or a B/D affiliated RIA will often find themselves practicing under the same four environmental influences as those previously outlined for Insurance Agent, Insurance Broker, and Registered Representative.

Historically, the Standard of Care has been viewed as follows:

Lowest Level – Broker/Agent
Higher Level – Registered Representative (focused more on "Suitability" than ethics)
Highest Level – Registered Investment Advisor and Trustee

It is important to identify the role that each professional classification serves in the Financial Services Industry. It is also important to understand the interrelationship of these roles to avoid potential conflicts of interest. Furthermore, it is important to understand the responsibilities of each role, especially in the manner in which the practitioner (planner/advisor) has been represented to the client. The planner/advisor is appreciably more objective in placing the client's interests first when a fiduciary standard is upheld in the financial planning engagement.

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In the financial services industry, financial planning advice is offered by various persons in various roles. Conflicts often emerge when the interrelationships between the client and those involved in the planning process are not clearly delineated and disclosed. Here are several questions to consider in that regard:

- Should it be permissible to allow a firm that has established a trusted advisor relationship with a client under the RIA umbrella of fiduciary standards for investment advice, to change the environment of that relationship, without disclosure, when working with other components of the financial plan?
- If one planning action requires full disclosure, wouldn't all actions require such?
- Should the planner/advisor be responsible to make the client aware of the importance of full disclosure and freedom from conflict of interest through each phase of the financial planning process?
- If a firm provides both investment advice and insurance design advice, have they clearly delineated and disclosed any potential conflict to the client?

Herein lies the problem; how do we define the functionality of the financial planning process?

Financial: Having to do with money resources, income, etc.; the science of managing money;

Planning: To make a plan of / structure; to have in mind a project or purpose; a diagram showing the arrangement of a structure;

Advise: To give advice to; counsel; to offer as advice; to inform; advising or empowered to advise;

***Fiduciary*:** Legally obligated to represent the client and act in their best interest. As such, the fiduciary must provide full transparency and disclosure relating to the advantages, disadvantages and risk of products, cost, structural functionality, alternatives, conflicts of interest, and compensation. Thus, the fiduciary is held to a much higher standard.

While some may view these questions as relative or ambiguous, it is vital to understand than many planners/advisors are finding their lack of fiduciary responsibility challenged through civil lawsuits. It is becoming increasingly clear that courts and arbitrators do not consider such questions relative or ambiguous. Ultimately, it will be the role of the court or arbitration panel that determines the role you have played and, in turn, the requisite level of procedural prudence that you will have to demonstrate.

Choosing the highest path of fiduciary care is the best protection for the practitioner and the client.

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5-STEP STANDARD OF CARE

Learning Objectives:

The objectives in this presentation are to provide you:

- An introduction to the concept of a "global standard of care" that is applicable to any advisor engaged in the financial planning process;
- The details of the analytical and design making process that supports the requirements of fiduciary protocol and standard of care;
- Information on the roles and responsibilities of a fiduciary advisor, and best practices and skills associated with a procedurally prudent process;
- The leadership characteristics that are essential to the role of the fiduciary minded advisor; and
- The procedures to assess the advisor's practice in order to best define its own alignment of risk management and fiduciary ethos©.

Step 1 – Analyze

Step 2 – Strategize

Step 3 – Formalize

Step 4 – Implement

Step 5 – Monitor

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Leadership Characteristics - (Authored by Don B. Trone)

We have identified the following characteristics as quintessential to an effective risk management decision making process.

Step 1 – Analyze
- Intelligent
- Deliberative
- Competent
- Procedural

Step 2 – Strategize
- Innovative
- Prudent
- Analytical
- Patient
- Purposeful

Step 3 – Formalize
- Decisive
- Strategic
- Pragmatic
- Communicative

Step 4 – Implement
- Courageous
- Exemplary
- Disciplined
- Fair-minded

Step 5 – Monitor
- Honest
- Diligent
- Accountable
- Genuine
- Motivational
- Steadfast

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Step 1 – Analyze

1.1 State goals and objectives

a. Clearly define the insurance and related risk management goals and objectives of the client;

b. Integrate both financial and non-financial issues in the process.

While the concept of financial planning was originally created as a needs-based selling vehicle, the methodology has matured to a higher level of fact finding for repositioning of assets and targeted objectives. It is important to push this activity higher in the area of holistic, non-financial goals that run congruent with the client's emotional and philosophical preferences. This then becomes a differential between the "transactional" recommendation and the "advisory" recommendation.

1.2 Define roles and responsibilities of decision-makers

a. Clearly define your role and responsibilities to the client;

b. Clearly define the role and responsibilities of the client;

c. Coordinate the preparation and delivery of proposals with other decision-makers involved in the risk management issues with the client.

Clear communication between the client, related parties and other advisors is necessary to ensure that a harmonious and coordinated relationship is created for the project.

1.3 Brief decision-makers on objectives, standards, policies, and regulations

a. Maintain unbiased examination without external influence (production quotas, proprietary products, incentives, etc.)

b. Discuss your fiduciary process for presenting cost-benefit relationships for each risk management issue that you will be addressing.

c. Present a description of basic life insurance policy styles so that future discussions on your recommendations will stay focused on the ability to resolve.

d. Follow "safe harbor" delegation requirements when lacking time, knowledge, or expertise in a particular insurance line.

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Step 2 – Strategize

2.1 Identify Assets

a. Identify client assets which have risk exposure;

   It is imperative to recognize, identify and view every asset, hard or soft, in order to ascertain the nature of the risk. Hard assets, such as equity investments, may have a risk exposure to market variation and volatility. Real estate has additional risk exposure, such as destruction due to fire or weather. The Human Value asset is exposed to the risks of death, diminishing health, disabling events, and loss of companionship. In addition, there may be specific family, charitable, and philanthropic desires that need to be addressed.

b. Establish that "cash" is an asset.

Although this may appear to be a fundamental statement, it represents a direct linkage to the investment advisor's fiduciary responsibility. Whenever a recommendation is made to obtain life insurance as a vehicle for risk management, a re-allocation of cash is required to pay the premium. Therefore, advice is given to move one form of asset (cash) to purchase another form of asset; life insurance (or annuity).

2.2 Identify sources and levels of Risk *(see page 22 for expanded categories and identities of risk issues)*

a. Survey each client's risk exposure and identify shortfalls and omissions;

b. Discuss economic and emotional impact content associated with each risk.

c. Have the client determine and vocalize the amount of risk tolerance for each issue.

2.3 Identify Time Horizons

a. Identify dates that risk exposure may terminate, or when certain events will likely occur (i.e. retirement, sale of a company, educational funding);

b. Estimate time needed to adequately make required adjustments or fund products and design strategies.

c. Establish client recognition that the management of risk for unexpected contingencies (uncontrollable events) such as health change or death requires immediate action.

Item "C" is too often assumed to be a "hard close" or "push" by many advisors due to the biased opinion of transaction planners. However, risk that you have no control over, and to which there is no predictable time frame, is the most dramatic risks of all and must be stated as a priority for action. If the advisor allows time to elapse between recommendation and implementation, and if during that time span the client becomes uninsurable or exposed to a higher rating table due to a change in health status, the advisor has failed in his or her fiduciary capacity. This reality of risk management must be disclosed and discussed to protect the client.

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2.4 Identify Expected Outcomes

a. Ascertain future cost and return assumptions and benchmark each component to a statistical standard of sustainability and/or historical cycles;

a. Integrate the appropriate analytical tools to confirm pricing and assumptions.

Certain methods and tools are required to thoroughly acquire and organize information and data in a comprehensive manner. When these methods and tools are utilized appropriately, the decision making process occurs in an environment of full disclosure.

Step 3 – Formalize

3.1 Define the strategy that is consistent with objectives

a. Consider non-insurance strategies that may reduce or eliminate risks.

b. Present alternative asset positioning and ownership options;

c. Determine the insurance or risk management strategies that will meet the client's goals and objectives;

d. Analyze adequacy of current insurance or risk management strategies for their ability of mitigating risk in the most efficient manner (i.e. existing life policies).

e. Ensure that the insurance or risk management product has been selected and designed in a way that represents the best interests of the client, trust, corporation, or retirement plan (both qualified and nonqualified).

f. Determining the appropriateness, merits and disadvantages of the use of life insurance for the stated risk management issue.

The term "Best Interest of the Client" is often mischaracterized as presenting a product that appears to be the cheapest in premium, or one that is void of commission compensation. There is no Prudent Principle or Fiduciary language that supports such characterization. Instead, the primary issue becomes that of the process used for the determination of why the product or strategy recommended provides the best cost-benefit advantage for the objective.

3.2 Ensure the strategy is consistent with implementation and monitoring constraints

a. Present definition of policy style function to substantiate any recommendation.

b. Explore all opportunities for use of no-load funding vehicles wherever available and applicable.

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Paradigm Shift of Life Insurance Risk & Fiduciary Impact

Old-Paradigm Policy Styles: Premium Dependent

- Term Life
  Risk – Insuring Company
- Whole Life
  Risk – Insuring Company
- Participating Whole Life – No Term Blends
  Risk – Insuring Company
  Fiduciary Responsibility – Advisor/Agent

Transitional Policy Style: Dividend Dependent

- Participating Whole Life - With Term Blends
  Risk – Shared by Client and Insuring Company
  Fiduciary Responsibility – Advisor/Agent

(The Higher the amount of term Blend, the higher the amount of Risk that is shifted to the Client. This also increases the Fiduciary Responsibility of the Advisor/Agent.)

New-Paradigm Policy Styles: Cash Value Dependent

- Universal Life
  Risk – Client
  Fiduciary Responsibility – Advisor/Agent
- Variable Life
  Risk – Client
  Fiduciary Responsibility – Advisor/Agent
- Indexed Universal Life
  Risk – Client
  Fiduciary Responsibility – Advisor/Agent

New-Paradigm *Hybrid* Policy Styles: Premium Dependent

- No-Lapse Guarantee Universal Life
  Risk – Insuring Company
- No-Lapse Guarantee Variable Life
  Risk – Insuring Company & Client

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3.3 Formalize the strategy in detail and communicate

a. Prepare a written insurance policy statement for each client;

b. Present information in jargon-free language, and ensure each client understands the components of the insurance strategy.

Step 4 – Implement

4.1 Define the process for selecting key personnel to implement the strategy

a. Define the due diligence process that will be used to evaluate insurance providers;

b. Demonstrate that the due diligence process was consistently applied;

c. Define and disclose supporting basis for recommendations.

4.2 Define the process for selecting tools, methodologies, and budgets to implement the strategy

Design the funding strategy (premium design) that provides:

- Maximum cost efficiencies.
- Maximum capital efficiencies (including leverage and arbitrage).
- Maximum flexibility (to allow for change and/or adjustments if needed).
- Maximum control (so that the client has more authority for action than the underwriting company).

Running multiple illustrations does not, in itself, suggest a fiduciary process, but only represents the first step for analysis. For example, comparing premiums and future cash values between several providers of a universal life (UL) or variable universal life (VUL) style policy is futile unless the projected costs used in the assumptions can be fully disclosed. Market return is not the primary risk in these policy styles.

For example, every advisor recognizes that an illustration of a VUL policy style has two erroneous calculations embedded in the ledger; (1) Assumed annual return is compounded on a static basis, and (2) The required "Zero" annual return does NOT reflect the worst scenario and has absolutely no significance. Markets are NOT constant, but vary, and an average return over time cannot be employed with a product that drags cost from the principle. In addition, we DO have markets that are negative, dipping below the flat, Zero floor of no return. Both facts void out the illustrated assumptions.

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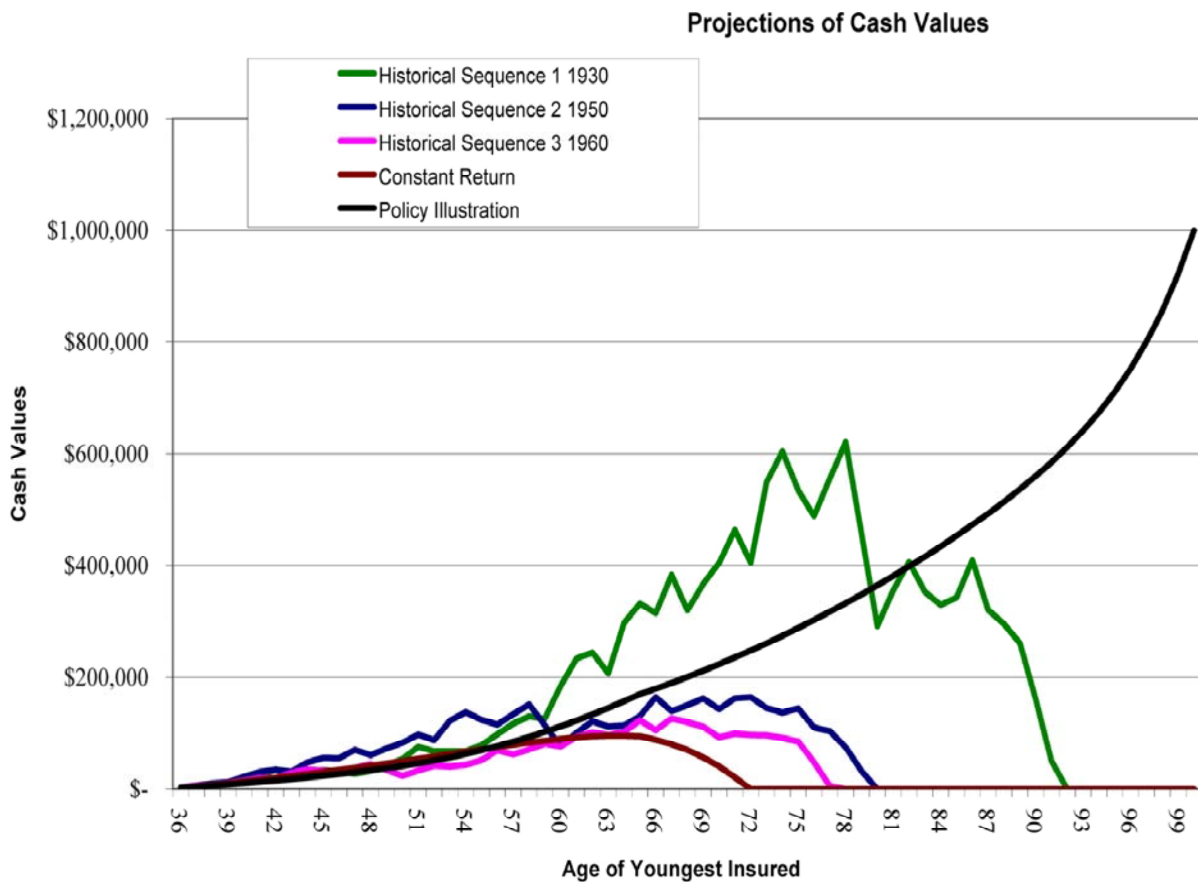
The graph below illustrates how a specific variable Universal Life proposal might perform once the illustration has been stripped of the erroneous static compounding calculation, zero minimum floor return assumption, and priced in line with a universally accepted mortality curve.

While the original illustrated proposal on this case was to endow at age 100, the analysis software indicates a higher probability of failure, with the policy lapsing between ages of 78 and 93.



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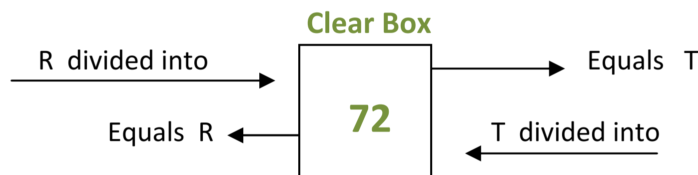
The Rule of 70 Something? (…and Illustration Software)

The Rule of 72 is used to: (a) determine how many years it will take to double money with a known Rate of Return, or (b) what rate of Return is needed to double money using a known time frame.

Rule of 72

Use of Three Factors: One is a **known** factor (72) which represents a **Clear Box**.
Two are ***unassigned*** factors (Time and Rate of Return)

To engage the process of calculation, a value has to be assigned to one of the unknown factors. If the *Rate of Return* (R) is defined, the calculation will solve for Time. If the factor of *Time* (T) is defined, the calculation will solve for the needed Rate of Return.

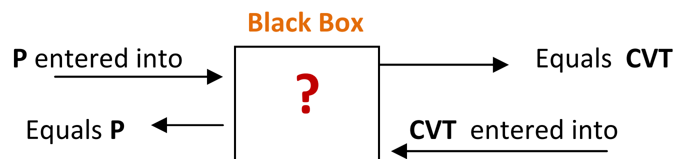


The resultant calculation for either R or T can be mathematically substantiated since the numerical component in the clear box (72) is known. The interchanging of factors represents a forward or backward calculation methodology.

Rule of 70 Something?

Use of Three Factors: One is an **unknown** factor which represents a **Black Box**.
Two are ***unassigned*** factors (Premium and future Cash Value Target)

The advisor assigns a numerical component to either *Premium* (P) or a future *Cash Value Target* (CVT) to initiate the calculation.



The resultant calculation for either P or CVT cannot be mathematically substantiated since the numerical component in the black box (?) is unknown. This "undisclosed" formula integrates policy expenses, loads, expense constants, COI's, and other actuarial assumptions to illustrate assumed future results.

Therefore, the lack of disclosure allows for any assumptive computation that is needed to produce a competitive illustration, without a requirement to substantiate the basis of the calculation. Neither the "Premium" nor the future "Cash Value Target" has a basis.

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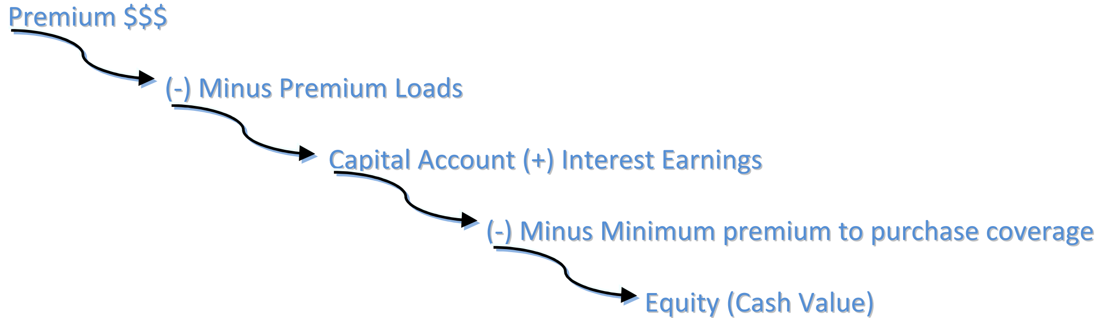
Character and Functional Nature of a Cash Value Dependent Policy Style

A "Cash Value Dependent" policy style is one in which the policy costs are taken from the policy cash values. Policy premium is an illustrated hypothecation that represents a strategy of deposits.

These policy styles are known as Universal Life and Variable Universal Life.

The simplicity of this policy style was to provide a cascading effect on capital contributions (premium deposits), which would work like this:



The original concept and design of this policy style was to provide the consumer with the following advantages:

- Transparency of all economic components
- Pass through of current mortality/pricing assumptions
- Pass through of current market interest rates
- Non-contractual premium requirements
- Policy expenses withdrawn from internal equity (cash value)
- Flexibility to control policy deposits (premiums)
- Flexibility to control and reconstruct death benefits
- High liquidity in policy equity
- Access to policy equity via withdrawals and/or policy loans
- Provide a tax-advantaged alternative to the "Buy Term and Invest the Rest" strategy

This design was transparent and simple: maximum flexibility, control, full-disclosure, high and immediate liquidity with no surrender charges *(see following chart)*.

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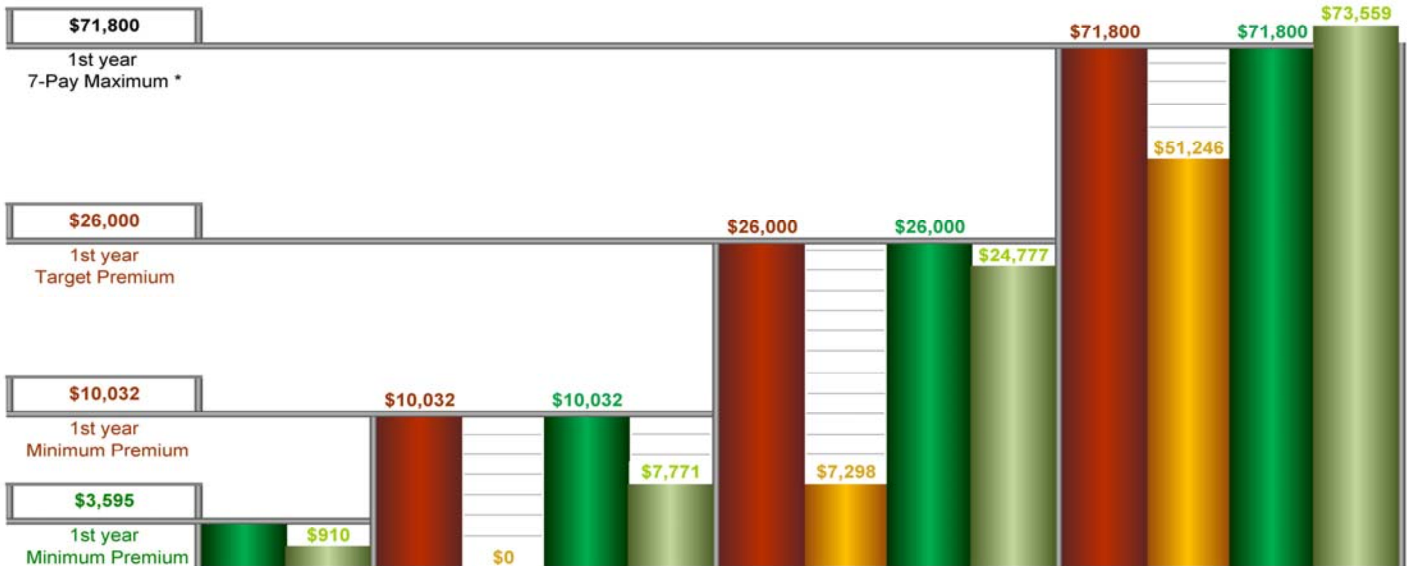
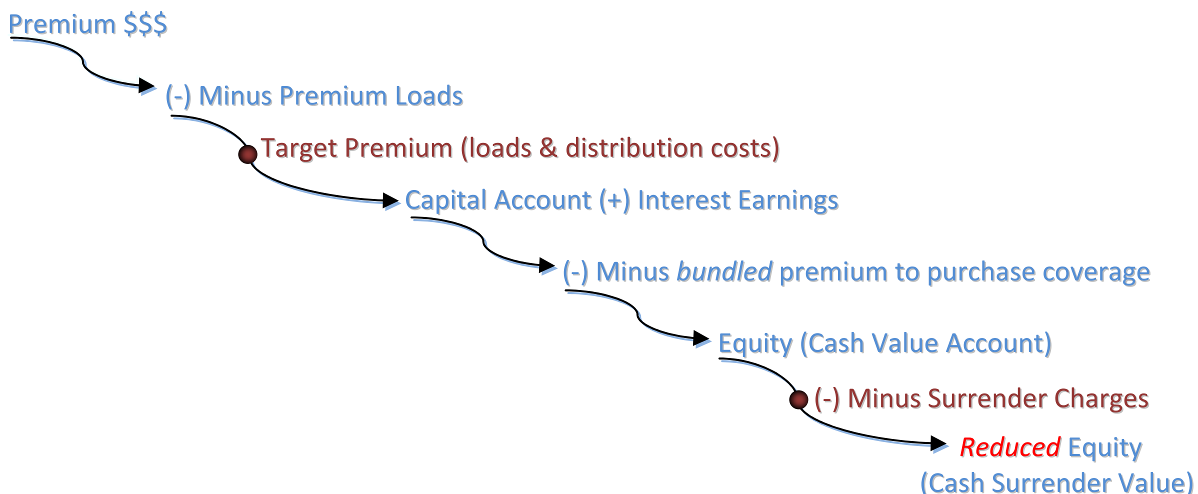


When it became evident to the insurance industry that the consumers embraced this concept, they had to re-work the original "fee-engagement" model to a "commission" model to make the product attractive to their distribution channel. To do this, an additional component (Target Premium) was added to the above referenced cascading cash flow configuration. The Target Premium is the calculation basis on which all of the maximum commissions are paid.

Look at what happened……

We now have the following adjustment:



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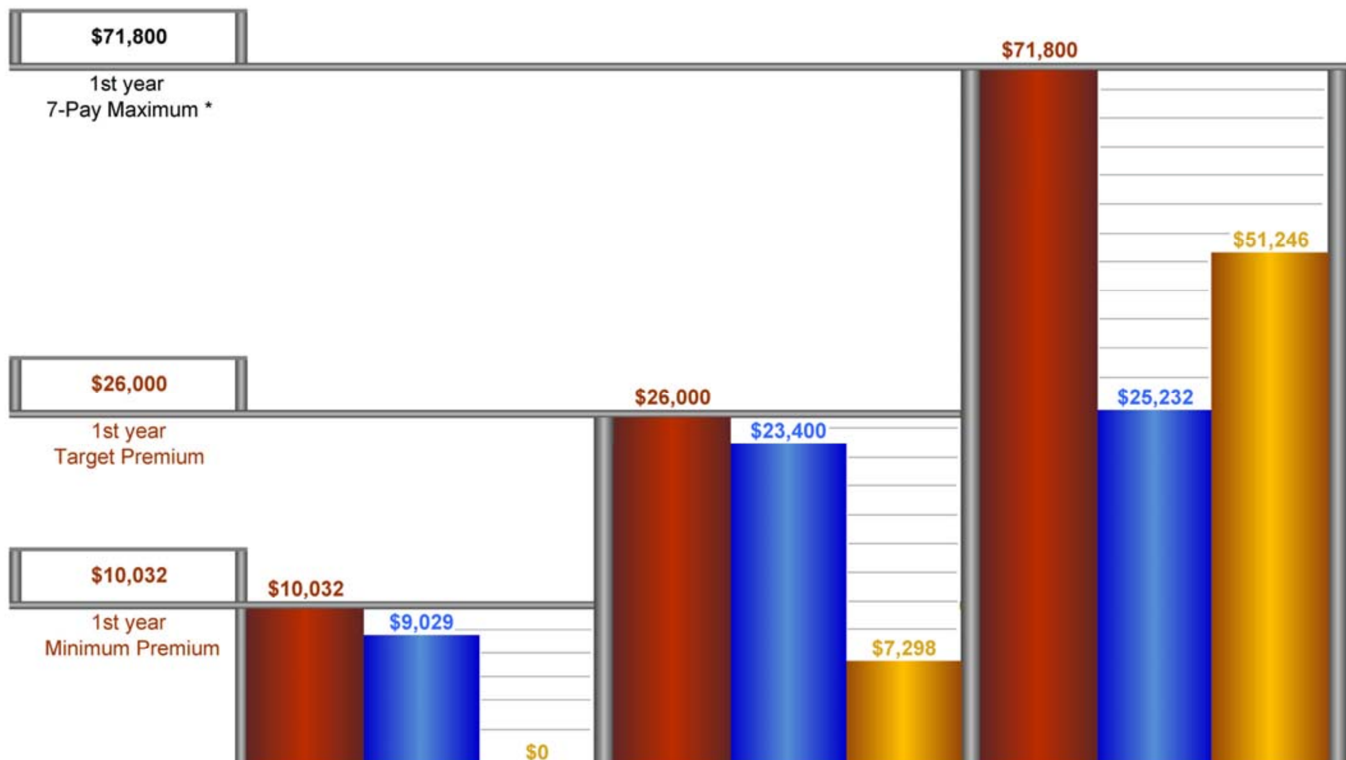
The following bar chart illustrates the affect of this Target Premium to the original concept of policy design.

Start by comparing the Minimum Premium, then track the increasing premium deposits as you pour more money into the policy, up to the maximum premium allowed by IRS guidelines (so as not to void all of the tax advantages of the policy)

We are assuming that the client is anticipating how much should be deposited in the first year of this universal life policy.



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4.3 Ensure that service agreements and contracts do not contain provisions that conflict with objectives

a. Explore all opportunities to reduce loads (front and back end) and commissions of commission-based products;

b. If load or commission reduction is not available in the selected policy style, disclose and support the appropriateness of the recommendation relative to the identified risk management objective.

The shift from commission to fee-engagement

The investment industry has been shifting from a commission based culture to a fee-engagement fully disclosed environment.

There are a few large Property & Casualty agencies that have replaced their product commissions with a fee-engagement, minimal commission structure.

Although a handful of life insurance carriers have developed fee-engagement life insurance and annuity products for advisors, called no-load or low-load products, the insurance industry has been highly resistant to this change, fearing a rebellion from its commission based distribution channel.

Step 5 – Monitor

5.1 Prepare periodic reports that compare performance with objectives

a. Define in the client's insurance policy statement the level and frequency of policy reviews;

b. In the case of insurance products that include an investment vehicle; periodically compare the performance of money managers to peers and indexes;

c. Annually update the client's insurance policy statement.

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5.2 Prepare periodic reports that analyze cost, or return, with performance objectives

a. Fully disclose and substantiate fees or commissions, and the effect on performance, if any;

b. Assess the complexities and service requirements of each client, and ensure compensation is commensurate with level of service being rendered;

c. Periodically monitor the financial stability and rating of product providers.

Monitoring Policies

Old-Paradigm Policy Styles

- Term Life: Shop the market every 3 to 4 years; Review exit strategies.
- Whole Life: Statement review / Loans

Transitional Policy Style

- Participating Whole Life – No Term Blends: Statement review / Loans / Dividends
- Participating Whole Life with Term Blends: Annually / In-force illustrations

New-Paradigm Policy Styles

- Universal Life: Annually / In-force illustrations / Comparison to original proposal
- Variable Universal Life: Annually / In-force illustrations / Comparison to original proposal / portfolio allocation.
- No-Lapse Guarantee Universal Life: Per contract premium payment frequency / Comparison to original proposal.

In all cases:

- Monitor and Review insurance carrier ratings, downgrades, watch list, etc.

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5.3 Perform periodic examinations for conflicts of interest and self-dealing, and breaches of a code of conduct.

a. Disclose conflicts of interest, real or perceived;

5.4 Prepare periodic qualitative or performance reviews of product providers

a. Monitor news for information on product providers;

b. In the case of insurance products that include an investment vehicle; monitor news information on money managers.

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2.2 Risk Identification

- **Current Risk / Future Risk**
- **Real Risk / Perceived Risk**
- **Risk / Wants**

  - **Asset Classification & Objective Relationship**
  - **Reduction of Assets**
    - ✓ Inflation
    - ✓ Market Volatility
    - ✓ Estate Taxes
    - ✓ Loss of Employment
    - ✓ Disability
    - ✓ Medical Expenses
    - ✓ Divorce
    - ✓ Reduction in Business Value
    - ✓ Litigation
  - **Loss of Assets**
    - ✓ Death
    - ✓ Fire
    - ✓ Weather
    - ✓ Theft
    - ✓ Other
    - ✓ Taxes (asset related, such as residence or property lost in default of property taxes)
    - ✓ Discontinuance of Business
    - ✓ Litigation
    - ✓ Bankruptcy
  - **Interest Rate Fluctuation**
  - **Illiquid Assets**
  - **Family Relationships**
    - ✓ Educational Funding
    - ✓ Special Needs
    - ✓ Wealth Transfer
  - **Business Relationships**
    - ✓ Business Continuation
    - ✓ Estate & Asset Liquidity
    - ✓ Key Employees
    - ✓ General Employees
  - **Health**
    - ✓ Underwriting Rating
    - ✓ Unable to Mange Everyday Life Functions
  - **Personal Comfort Zones**
    - ✓ Charitable and Philanthropic Desires
    - ✓ Debt-to-Income Ratio
    - ✓ Discretionary Income Spread
  - **Unfulfilled Objectives**
  - **Retirement**
  - **Social Security and Medicare**
  - **Time Horizon**

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Here is how we assisted an advisor with helping their client:

SAMPLE CASE

Objective: High net worth client has been participating in complex estate planning activity that required the formation of a joint-life Irrevocable Life Insurance Trust (ILIT) which was to fund a $10 Million survivorship (last-to-die) policy.

Client had been presented with a $10 Million survivorship policy proposal from a large, well known participating whole life company.

Advisor Fee- Engagement: The advisor was asked to provide a policy proposal review and submit recommendations.

Start of Project: An interview with the client was scheduled after all pertinent data as to amount and form of assets, the types of estate planning documents that had been created and initiated, personal information with regard to family members and ages, etc.

The client interview established that the client was familiar with risk tolerance, had a background of investment banking, was concerned about wealth preservation, and had a long relationship with the agent who had provided the proposal under review.

Analysis: The proposal under review was comprised of a participating whole life base policy ($2 Million) which carried contractual guarantees of the stated premium, cash value and death benefit attributed to that component of the proposal. In addition to this base policy, there was a highly leveraged term rider ($8 Million) which did not provide guarantees of premium or death benefit.

The proposal did not disclose the total cost (per annum) of the term rider in future years, neither did the proposal disclose the Cost-Per-Thousand (per annum) of the term rider in future years. In addition, the proposal did not disclose the effect upon projections should the current dividend scale be reduced in the future. The proposal was full of omissions (void of disclosure) with regard to most of the pricing economics needed for review to substantiate the probability of continuance.

The analysis demonstrated that policy performance was heavily dependent on dividend history and projections, and that recent dividend history was on a decreasing momentum. The advisor disclosed these issues to the client.

In addition, the annual premiums exceeded the amount of annual gift tax exclusion allowable for the number of named beneficiaries to the Trust.

Problem: The policy proposal lacked transparency and disclosure; the client did not understand that the performance of the policy was heavily dependent on divided projections; the client did not understand that the guarantees were those only attributed to the base policy; and the proposing agent did not discuss the annual gift tax exclusions. In fact, the client was under the impression that the death benefit and illustrated premiums were guaranteed.

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Recommendation: The advisor offered two alternative recommendations.

1) A Guaranteed No-Lapse Universal Life policy style featuring a guarantee of stated premiums as illustrated, along with the guarantee on the full $10 Million death benefit for life. The annual premiums were within the annual gift tax exclusions.

   Although several companies had provided slightly lower premiums, the cash value curve of the recommended policy was sufficiently higher, with lower early-year surrender charges, so that the degree of flexibility was increased in the event of a changing future event.

   Through analysis of the cost-benefit ratio with increased liquidity, the recommended policy was best suited for the personality of the client.

2) A No-Load Survivorship Variable Universal Life (SVUL) policy style with the same amount of death benefit, but with no future guarantees with regard to premium or policy continuation.

   This policy illustration had been analyzed and benchmarked against a globally accepted actuarial curve to support future pricing stability. In addition, the Life Analyzer (analytical software for examining UL and VUL policy styles) stripped out of the illustration the constant compounding of the assumed annual return, allowing the advisor to overlay historical market performance in various time cycles as far back as 1926. Through this approach, it was deemed that the projections would have a high probability of success as long as the underlying portfolio (asset mix) was monitored and managed.

   This policy style offered maximum flexibility and control of premium, while providing the same $10 Million of death benefit with much higher cash value and liquidity than the original proposal (which also had limited guarantees), as well as that of the (1) policy style recommendation.

Conclusion: Due to the experience and risk tolerance of the client, recommendation #2 became the selected policy style.

The client was provided with a list of advantages and disadvantages of each of the policy styles recommended; All suitability requirements had been met as well (secondary issue compared to fiduciary requirements, but still necessary); Full disclosure was included as to the commission compensation derived from recommendation #1, and the Implementation Fee that was required by the advisor for the design, submission and monitoring of the underwriting process for recommendation #2.

All issues were communicated and coordinated with legal counsel, CPA, and Financial Advisor.

NOTE: Although the SVUL policy style is generally considered as the least desirable policy style for an ILIT, in-depth and frank discussion with the client, in an open and fully disclosed venue, may make this policy style the best cost-benefit resolve.

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