EQUITABLE

Life insurance policy review

It is prudent for charities that own life insurance to conduct a periodic review of the performance of life insurance policies that are included in their asset portfolio. These comments and the accompanying checklist are provided by us to assist financial professionals who are working with charitable organizations.

Many charities own life insurance policies on donors or on the lives of their key employees. Many of the issues addressed on the checklist or discussed here are also important considerations when a charity is considering the purchase of life insurance on a donor or key employee. Many of the review topics will be the same as those faced in reviews by trusts and businesses, as well as individuals. These can include a review of the purpose, the policy and the health of the insured. As fiduciaries, officers of public charities may be held accountable for the financial impact life insurance policies, as well as other assets, may have on the overall investment results of the portfolio of the organization.

Facts and circumstances

Unlike most other portfolio assets, the purpose of the life insurance, along with the facts and circumstances surrounding the purchase or gift to the charity, will remain an important element in any policy review and the decisions that may follow. This can include any promises made by the organization or commitments made by the donor upon the purchase or the acceptance of the contribution of the life insurance policy. The charity may have agreed to limit the use or application of the policy values. The donor may have committed to make future premium payments. A change in the donor's economic situation or the charity's mission can require a policy review.

Charity charter

Many charities have their own gift acceptance and investment policies. Where investments are involved, whether or not activities are "prudent" can depend on the organization's own charter or statement of purpose. Life insurance will often be considered along with other traditional investments.

State law

Charities may also face limitations or guidelines that may also be imposed by state laws. One such law is the "Uniform Prudent Management of Institutional Funds Act" (UPMIFA), which has been adopted by most states. The UPMIFA generally applies to items such as endowment funds, board-designated funds and restricted gifts. It does not apply to assets held for a charitable purpose, for example, the laboratory equipment owned by a university, the house owned by a homeless shelter, and the food storage building and food preparation equipment owned by a soup kitchen. Donor intent is given express priority throughout UPMIFA and could supersede the UPMIFA default rules.

UPMIFA adopts a prudence standard that directs those responsible to act as a prudent investor would, under similar circumstances. It mandates a diversified portfolio approach for investments, absent any special circumstances, and timely decisions regarding the disposition of newly received property. In all cases, institutions must keep in mind their charitable purposes and those of the particular endowment or restricted funds.

Those responsible for management and investment have a duty of care, a duty to minimize costs and protect values, and a duty to investigate and verify facts surrounding assets held by a charity, which can include life insurance as an asset. The duty of loyalty remains mandatory under other applicable laws.

Understanding life insurance products and the insurance industry

It is obvious that in addressing the investment duties and responsibilities, an understanding of life insurance, as well as the life insurance industry, are important elements. The financial professional is best positioned to offer this technical support to a charity and their financial officers who are accountable for the health of the organization's asset portfolios. There may be less for the charity to consider in situations where a donor is continuing to support premium payments on a life insurance policy they donated. In those situations it may be appropriate to offer policy review services to the donors themselves. For situations where the life insurance policy premium requirements are no longer financially supported by the original donor, it would be prudent to consider factors that can impact the value of the individual policy such as:

- The financial health of the company that issued the policy;
- Changes in the policy's financial results;
- Industry/product changes that may result in an opportunity to obtain greater benefits for the same outlay.

Concerns with life insurance company ratings

Since life insurance involves the promise to make funds available in the future, financial stability of the insurance company can be a major factor in the decision to maintain or replace an existing policy within a portfolio, as well as to purchase a new policy. A substantial negative shift in an insurer's ratings can be a cause of concern. Financial strength can be more important than the initial price or the illustrated performance of an insurance product.

Many insurance purchasers are unaware that there are a number of independent rating services available that address an insurer's financial strength. Companies are rated based on financial soundness, credit ratings and debt ratings that can impact their ability to meet projected returns and ensure that death benefits will be paid. There are four major industry rating services that evaluate the financial strength of life insurance companies: AM Best, Moody's, Standard & Poor's and Fitch. Life insurance companies' financial strengths are ranked by these independent services using their own scales. Although their reviews are conducted on an ongoing basis, the major rating agencies also prepare and publish annual reports.

Each rating company uses a different rating schematic, but all provide ratings using letter grades or codes, A, B, C, etc., with plus and minus to indicate gradations. A company's rating is the means a rating agency uses to objectively report a life insurer's financial strength, as well as a means of relative comparison of all companies reviewed. It has been suggested that a good strategy would be to compare results from the major rating agencies and the life insurance companies whose products are under review should be rated A and above by at least two of the four major rating agencies.