The BottomsLine | SPRING 2020

SPECIAL LIFE INSURANCE EDITION

Because of the current economic environment, this issue is a Special Edition focused upon life insurance - which is one of our specialties in addition to employee benefits. Please consider the narrative below to be a resource as financial security plans for the future are considered.

Dear Clients and Friends:

We love surprises. Like a birthday party...or the delivery of a thoughtful gift, or handwritten note. Unfortunately, we know that life inevitably gives us some bad surprises, sometimes suddenly.

Like a health event that comes out of nowhere and takes a life, or diminishes income and financial resources that are needed for support...or the jolt of suddenly being in business with your deceased partner's family...or realizing there's not enough cash to support the later years that you and your loved ones envisioned. Or, maybe even facing the financial consequences of a global pandemic.

We can't tell you when surprises will happen, or what those surprises will be. But together we can take meaningful financial steps to help you get to where you want to be. Our corner of the financial security world is changing fast. Here's our take on the current environment.

WHAT'S INSIDE:

The Bottoms Group, LLC, has for decades been listening to clients and developing employee benefits, insurance and estate planning solutions customized to their unique and changing needs. For more information about TBG, visit www.thebottomsgroup.com.

OVERVIEW

For perspective, it's always valuable to take a look at history. Life insurance is an old business so there's lots of history to study. The first company was the Presbyterian Ministers Fund, organized in 1759. Since then, there have been several tough spots to navigate. The Spanish Flu in 1918 caused a temporary blip in mortality experience but diminished and disappeared in a matter of months. Approximately 675,000 Americans died during this time. US insurance companies survived and paid 0.5% of GDP in death benefits which is $30 billion in today's dollars. By comparison, in 2016, they paid $76 billion in death benefits.

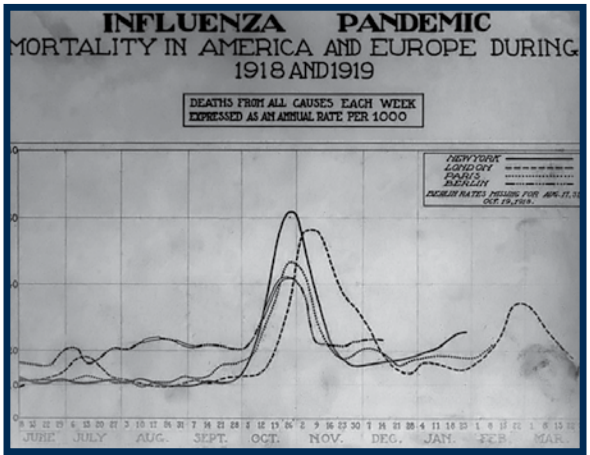
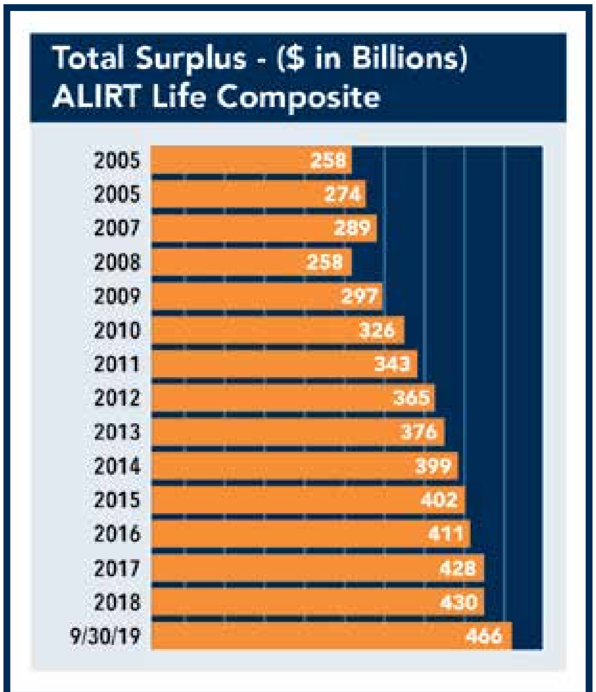


Image courtesy of the National Museum of Health and Medicine (Public Domain)

Here's a quote from 1922 in *The National Underwriter*, an old industry publication: the epidemic "has brought forward the benefits of insurance to the people in a way that they had not appreciated... every community where deaths have occurred in large numbers from influenza, the first question that arose was whether the deceased carried any life insurance."



ALIRT United States Life Insurance Industry Review (2019)

ALIRT Insurance Research offers independent analysis of insurance company risk trends, and they recently released their *First Quarter 2020 and its Impacts on Life Insurers* report. The report is extensive and notes in the conclusion that "the activity in the first quarter 2020 did not approach the adverse conditions faced by life insurers during the financial crisis in 2008-2009. The decline in stock markets was less severe than that incurred during the 2007-2009 bear market, and thus the impact to insurer statutory reserving, earnings, capitalization and 1Q 2020 is likely to be correspondingly smaller than during 2008-2009."

Nevertheless, it's a complex endeavor to manage a life insurance company these days in the low interest rate environment. Balancing long-term financial stability and current competitiveness is a challenge. It always has been this way but the landscape has shifted. Decades ago most insurance agents were employees of their primary company and client relationships were developed going door to door. I'm familiar with this method of insurance distribution because this is the way my Dad supported our family.

However, over the past 20 or 30 years, clients have come to prefer an independent insurance advisor connected to a national producer group. There are only a handful of these invitation-only organizations that facilitate a long list of direct insurance company relationships, intellectual capital, underwriting and service leverage, along with access to the technology needed to deliver the experience that our clients want. The Bottoms Group has a long-standing relationship with two of these organizations: Lion Street for life insurance and NFP Benefits for employee benefits.

A successful life insurance experience can be described similarly to a successful plane ride. That is, a successful takeoff is important but also a comfortable ride and successful landing is also essential. All of this means that the insurance companies must carefully balance competitiveness with the ability to deliver what the client wants over what could be a very long time span. In a way, they are under a financial microscope. Thus, the stability of the underlying assets needed to deliver on obligations is an important factor to consider.

General Account Investment Mix — ALIRT Life Industry Composite

	2015	2016	2017	2018	2019
Inv. Grade Bonds	69.7%	69.0%	68.3%	68.0%	66.9%
Non-Inc. Grade Bonds	4.5%	4.6%	4.3%	4.0%	3.8%
Mortgage Loans	11.6%	11.9%	12.4%	13.4%	13.7%
Real Estate	0.6%	0.6%	0.6%	0.5%	0.5%
Unaffiliated Stocks	0.9%	0.9%	1.0%	0.9%	0.9%
Affiliated Stocks	2.5%	2.5%	2.5%	2.4%	2.5%
Policy Loans	3.5%	3.4%	3.3%	3.2%	3.1%
Schedule BA	4.4%	4.3%	4.5%	4.7%	4.9%
Other Invested Assets	2.4%	2.8%	3.1%	2.9%	3.6%

Source: "ALIRT Life Insurance Industry Review Year-End 2019"

Life insurance companies want to be competitive as well as financially stable. Clients want financial protection with no surprises along the way.

Warren Buffet has a great line: "it's only when the tide goes out that you learn who has been swimming naked." Well, the economic tide just went out. The sudden presence of a pandemic has been a reminder that our lives, as well as our resources, can quickly become fragile.

PROCESS

A unique confluence of events has taken hold in the marketplace: (1) persistently low interest rates that just went lower; (2) a rapid decline in asset values; and (3) an artificially higher estate and transfer tax exemption. Many of our client families should consider whether the time is right for them to review and possibly update their plan.

Our life and disability insurance recommendations are presented with summaries comparing multiple insurance companies. Insurance is not a commodity, and our comparison process includes many factors. A critical ingredient are the financial ratings for the insurance companies. We include the Comdex rating, which is a composite score averaging the ratings of the major insurance rating organizations including A.M. Best, Fitch, Moody's and S&P. The Comdex rating is on a number scale of 1 to 100, with a higher number being the better rating. We like ratings of high 80s or better.

The pandemic is bringing about change to the underwriting process for new applications. In recent years, it has become quite common for the process to take up to eight weeks and sometimes longer between the time the application is taken and the underwriting decision is made. This timeframe is less than ideal. The difficulty of obtaining medical records on a timely basis has become a constraint. And, the sharper the underwriter's pencils become, the more detailed information they need for their files and decisions.

Recent changes should speed up the process and, in many cases, avoid paramedical exams because of the "social distancing" constraints. Some carriers are willing to mail an exam kit directly to the applicant's personal physician, and recent annual exams can be sometimes used instead of the typical insurance exam. Some carriers have recently introduced an underwriting process that does not involve a medical exam for given ages and insurance amounts. The underwriters determine on a case-by-case basis what they want. The use of technology platforms utilizing electronic signatures are becoming acceptable.

Some carriers are temporarily restricting applicants at older ages, such as 70 or 80, and postponing applicants that have a history of chronic respiratory conditions. Future foreign travel is being scrutinized; it is also likely that we will be seeing new premium or total face amount limits with some insurance companies.

The insurance company underwriter's mindset improves when the application is accompanied by a carefully composed cover letter detailing the purpose for the insurance amounts being requested along with an explanation of the strategy involved. Often a portfolio of different policy types is requested as well as applications being placed with multiple carriers.Underwriters have a distaste for mystery thus the need for clarity around the overall plan.

PURPOSE

The financial security conversation is all about the client. It is not like the IRS process of inputting data and submitting a tax return. None of us are required to implement life insurance coverage and there are no formulas or deadlines. From the insurance advisor's standpoint, a carefully refined skill at asking questions and listening carefully is a critical ingredient in developing clarity throughout the process along with confidence that the appropriate decisions are being implemented.

A good place to begin is to ask, "if (fill in the blank) occurs, what needs to happen?" There is a long list of possible needs that might be identified. Common themes may be support for a young family, or empty-nester's concern about the cost of long-term care, and the realization that it is not uncommon to live into the 90's which may be 30 years after retirement. There may be adult children from a previous marriage that need to be considered. There may be a family business involved or other illiquid assets which complicate the estate equalization plan. Perhaps consideration is needed for a special needs child in the family. Given the answers to the questions, a design can be engineered. We cannot predict the future for our clients, but we do help them prepare for it.

And yes, for many, there's still concern about estate taxation; in our view, there's not a lot of sympathy for high net worth individuals or families. The Tax Cuts and Job Act ("TCJA") temporarily doubled federal gift, estate, and generation-skipping transfer ("GST") tax exemptions. The present $11.58 million lifetime basic exclusion amount per person will revert to pre-2018 law on January 1, 2026, or maybe sooner if there is a political power change. Therefore, many financial advisors are having conversations with their clients related to gifting assets and planning for the future.

Speaking of financial advisors, we believe clients and families are best served when there is a planning team involved. For most of our clients, essential members of the team are an estate planning attorney, CPA, wealth manager and the insurance advisor. The attorney has all of the legal documents and understands the big picture of how the estate plan will operate. The CPA has the history of working with the family and the expertise to help the family navigate the complexity of today's tax laws and opportunities. The wealth manager's role is central because they often are responsible for carefully managing the result of a lifetime of work, creating confidence among ongoing survivors. We highly recommend, and often assist, with the creation of advisory teams for our clients.

Where life insurance is needed, the design may be death benefit oriented or cash accumulation oriented, or a combination of both. The amount of death benefit needed will likely change over time. It may be a temporary need, such as 10 years, or it may be a permanent need, as in for life. So, the duration of the need is a big piece of the equation. It is important to realistically think this through.

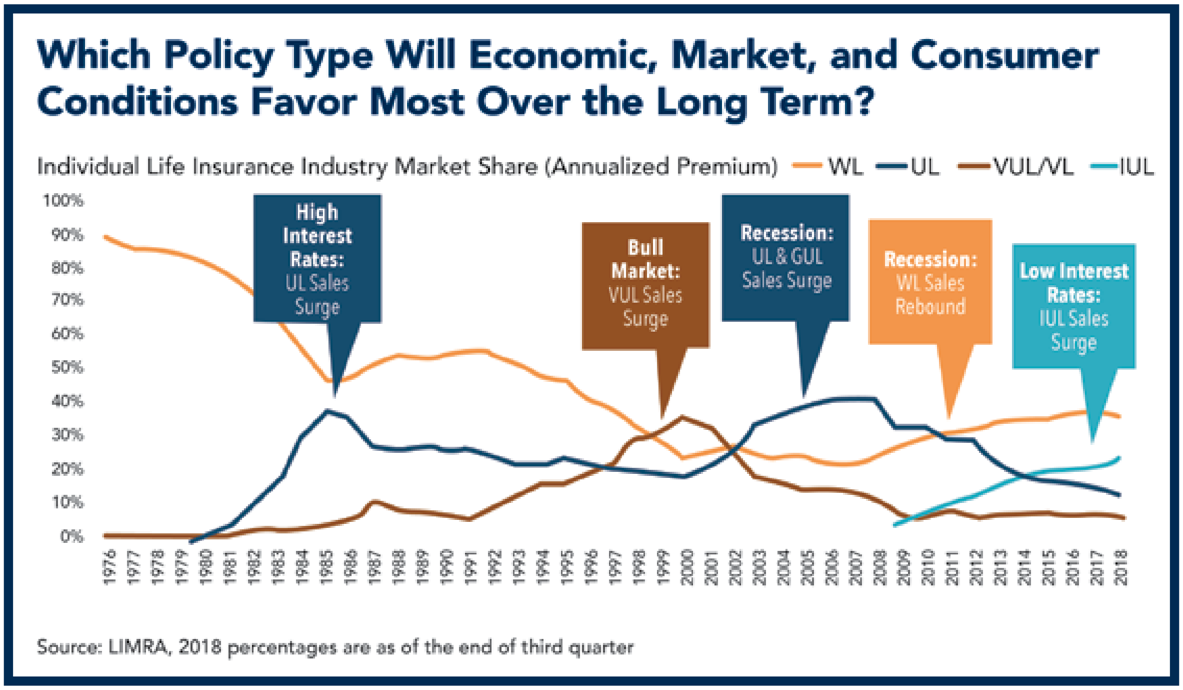
Accumulated cash can solve a lot of problems. It can provide funding for supplemental retirement income, pay expenses for long-term care, or provide funds for anticipated opportunities like starting a business. In times of uncertainty (like now), Americans tend to turn their attention to their liquidity—how much cash is available. Some life insurance products, if they are properly funded, can accumulate cash.

Walt Disney borrowed from his life insurance in 1953 to help fund Disneyland, his first theme park, when no banker would lend him the money. In short, a primary purpose of life insurance is creating margin in our financial lives.

The “Holy Trinity” of life insurance is: (1) the income tax-free death benefit; (2) tax-free growth in the form of a policy’s accumulated cash value; and, (3) the ability to take tax-free or tax-advantaged loans.

PRODUCT

Along with everything else in our economy, technology has changed life insurance forever. If you want a guaranteed death benefit for life, you can have it. If you want an opportunity for market-driven cash accumulation, you can have it. If you want a relatively low premium for a given death benefit, at least for a while, you can have it, and more. That is, if you are healthy. But, you may not be able to obtain all the attributes you desire within a single insurance contract.

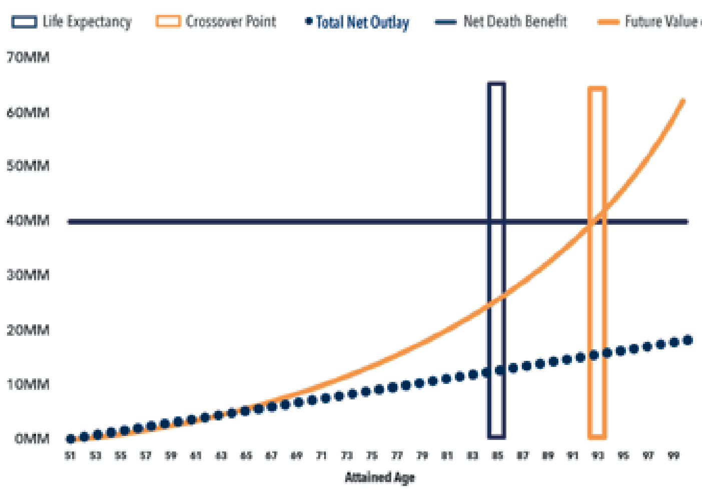


In today’s economy, we believe diversification of a life insurance portfolio is wise in most cases. Risk is reduced because there is less dependency on economic or market forces that influence the optimization of any one type, and on any one carrier’s financial strength or competitive standing. Nevertheless, due to a disparity of underwriting offers from the various carriers, it may be advisable to place the coverage with the carrier making the best “health classification” offer.

Diversification can make a life insurance strategy more durable, sustainable and responsive to any market and/or economic environment. One contract may come with an extended death benefit guarantee while another may provide a high level of death benefit guaranteed for a limited number of years. Another addition to the portfolio may be oriented toward cash accumulation along with a provision for coverage for long term care expenses.

Life insurance is highly regulated, and because of the extended low interest rate environment we have been in for a while, the cost of policy guarantees has been increasing. Life insurance product innovations have created opportunities for investment control and flexibility mixed with long-duration death benefit guarantees, even for lifetime if desired.

Economics of Life Insurance - The Basic Concept



(1) Year	(2) Attained Age	(3) Cumulative Net Outlay (Includes Any Gift Taxes)	(4) Death Benefit Minus Estate Tax on 3 Years of Gift Taxes Paid	(5) Future Value of Cumulative Net Outlay	(6) Death Benefit Cost Per Dollar (5) ÷ (4)
1	51	362,998	40,000,000	287,324	0.01
5	55	1,814,990	40,000,000	1,591,204	0.04
10	60	3,629,980	40,000,000	3,307,100	0.08
15	65	5,444,970	40,000,000	5,736,250	0.14
20	70	7,259,960	40,000,000	8,897,597	0.22
25	75	9,074,950	40,000,000	13,016,310	0.33
30	80	10,889,940	40,000,000	18,384,437	0.46
35	85	12,704,930	40,000,000	25,384,768	0.63
40	90	14,519,920	40,000,000	34,518,135	0.86
45	95	16,334,910	40,000,000	46,442,291	1.16
50	100	18,149,900	40,000,000	62,014,860	1.55

Hypothetical and for illustrative purposes only. Actual results may vary.

The purpose of life insurance has always been the creation of capital. The economics of the concept have stood the test of time. What has changed over time is that with the increasing flexibility of the products comes an increased responsibility for client understanding and periodic reviews. After all, it is important for the contract to remain in force long enough so that it can accomplish its purpose. Otherwise, it is like playing a great game and losing it in the fourth quarter.

When we can be helpful, please allow us the opportunity.

Yours very truly,

Gary Bottoms

The Bottoms Group, LLC
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