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Life Insurance For Executives: What Large Employers Need To Know

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SUMMARY

- Group insurance plans alone rarely meet the needs of higher compensated employees.
- Coupling group insurance with the right individual plan can usually help fill the gaps.
- Employers can use Individual Life insurance products to build cash value for them and their employees.
- Regular review of plans and their purpose is imperative to check performance against company financial goals – and ensure new financial opportunities are not being missed.

I. INTRODUCTION

When it comes to attracting and retaining the best executive level staff, it's no surprise that the benefits they expect to receive play a huge role in their decision to join a company. Most employers understand that they need to provide more appropriate benefits for their highly compensated employees. Benefit packages typically include deferred compensation, but employers may be missing opportunities to provide more immediate coverage for the highly compensated executives in the form of Individual Life insurance plans. Even if those types of plans are already in place, employers may be surprised to learn that their current policies underlying their employee group plans could be in jeopardy and end up costing them much more than they expected - sometimes several million dollars more.

The Bureau of Labor Statistics estimates there will be 2,125,700 top executives in the corporate market by 2018. According to a 2012 paper from MetLife, Inc. on executive benefits *(Watch the Gap! Recalibrating Income Protection Benefits For Highly Compensated Employees),* nearly half of current high earners (considered $100,000+ in base salary) say that their benefits are the "foundation of their financial safety net" versus 33% of other employees. The same paper indicates that almost half of high earners surveyed (47%) cite their work benefits as a reason they came to work for their current employer versus 31% of other employees that said this. Benefits are also a reason for remaining with their employer for 51% of high earners versus just 40% of other employees, according to the paper. Additionally, more than half of highly compensated employees say they are very concerned about the financial effects of a loss of income in the event of a disability and/or premature death.

While several developing countries expect a surplus of skilled talent over the next decade, more mature economies such as the U.S. are already facing shortages of skilled talent. These markets are also going to continue to compete globally for the best talent. Given this, a "one size fits all" approach to employee benefits (that is, group plans that treat everyone - despite age, life stage or personal circumstances - exactly the same) will not work in the future, particularly with higher level employees. With employee benefits becoming more consumer- driven overall, "one size fits one" will become the new norm.

While most information available on executive benefits typically deals with salary, bonuses and retirement – and the time spent by benefit heads for executive benefits tends to be focused in these same areas as well - there are several additional options for employers to consider when creating a robust and attractive benefits package for highly compensated employees. Life insurance, in particular, is an important incentive for highly compensated employees since it serves as income replacement for their families in the event of their death. But life insurance doesn't have to be just about the employee. In fact, there are many ways employers can use life insurance policies to help fund executive benefit plans. There are a variety of different life plans available that companies will need to better understand before considering them for their executives.

II. TYPES OF LIFE INSURANCE POLICIES

GROUP VERSUS INDIVIDUAL PLANS

While all insurance products have some positives and negatives, traditional group plans are the norm for most company's executive employees. Unfortunately, group plans tend to fall short in meeting the needs of the higher earners, particularly when it comes to benefit amounts, definition of earnings, and portability features. Most life programs are based on earnings up to a specific amount, i.e., five times an annual income up to $500,000, which leaves many highly compensated employees under-insured relative to their income. There are several ways that you can use life insurance to enhance, substitute and complement your existing benefit programs for executives – and this doesn't have to mean replacing your existing plans or platforms.

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INDIVIDUAL LIFE PLANS

There are essentially two types of individual life insurance products: temporary (also known as "term life") and permanent.

Term Life

Designed to last for a certain period of time or "term" (i.e. 20 years), Term Life is basic insurance, where the premium buys protection in the event of death. Generally speaking, there are three areas to consider when it comes to term insurance: 1) The death benefit amount needed, 2) Length of coverage, and 3) The premium needed.

Term Life is usually much cheaper than permanent insurance. However, once the term has expired, coverage will no longer exist or the price will go up. Term Life is typically used as a cost effective way of covering a need for the length of the term. It is one dimensional in nature, meaning if the insured dies during the term, then the insurance company will pay. Generally, Term Life will not return any premium dollars if no claims are made - similar to what is usually expected with auto and home insurance. Depending on an individual's circumstance, this can be a good lower-cost option.

Permanent Life

This is a life insurance policy that is designed to last as long as the insurer does – it never expires (hence the name "permanent"). A permanent insurance policy also accumulates a cash value reserve that can be used for the benefit of the policy owner and, if it increases enough, it could actually pay the premiums for you.

The main difference between term and permanent life insurance is similar to the difference between renting and buying a home. When you lease a home for a specified period of time, when that time is up, you can pay the update updated rate and stay or walk away – you owe nothing and you get nothing. Permanent insurance is more like buying a home – it's a lot more expensive initially than renting, the mortgage payment (assuming it's fixed) never changes, it can be paid off, and presumably the value of your asset increases over time. It's more of a three-dimensional is a working asset for the insured.

There are two types of permanent life insurance policies:

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1. Whole Life

For employers that want to offer their employees more, whole life is considered the "best of the best" of permanent life insurance policies. While it is more expensive, it offers a guaranteed death benefit, cash value, policy dividends and, most importantly, has fixed annual premium payments – so you never have to worry about the premium changing.

2. Universal Life

The main feature of Universal Life is that it allows for fluctuation of the premium. This means if you can't afford the same fixed monthly premium payment, it doesn't impact the policy. This type of insurance leverages investments and market conditions to offset premium payments, but still retains the policy growth.

The premiums are broken down by the insurance company into insurance and savings, allowing the policy owner to make adjustments based on their individual circumstances. Universal Life insurance has a fixed-rate component, offering policyholders a minimal annual return, after deductions for expenses, usually in the 3% to 4% range. (Returns can be slighter higher, but contractual guarantees on these policies typically establish a preset minimum return.)

Variable Life is a permanent, Universal Life insurance policy that allows the policyholder to direct how the dividends are structured, i.e. whether they are invested in the market or invested in the actual insurance company.

III. POLICY REVIEWS

No matter what type of life insurance you select for your executive employees, the plans and underlying policies need to be reviewed and monitored periodically to ensure they are performing as intended. Pacific Resources has uncovered several issues with life policies when reviewing them for clients.

If you haven't reviewed your company's life policies within the last five years, you're strongly encouraged to do so. Remember, many policies were put into place during much different economic times, particularly when interest rates were significantly higher, so the policies may not be not performing as expected. Companies inadvertently throw away hundreds of thousands of dollars each year because they don't review their plans.

In light of current market conditions, and depending on policy structure, your company may also unknowingly be facing early termination of a product, or there may be a gap in premiums that could require a large infusion of cash to keep the product going.

IV. NEXT STEPS

Overall, one of the best practices for ensuring that highly compensated executives have parity in the coverage they receive is by combining group and individual insurance. In most cases, individual coverage can help fill the gap – sometimes a significant gap - that exists for higher compensated employees. Employees at all levels rely heavily on their employer to vet any policies being offered, so individuals may not be aware of any serious gaps or issues – until it is too late.

For a complimentary audit of the life insurance plans for your company's highly compensated employees, please contact your Pacific Resources Account Executive or Scott Silverman at scott.silverman@pacresbenefits.com

About the author

Scott Silverman is Vice President of Pacific Resources' Executive Benefits Practice. He helps companies align their executive benefits programs with their long-term organizational goals and executive expectations, while also fully complying with regulatory requirements. A former practicing lawyer, Scott understands clients' needs from a business, legal and insurance perspective. Clients can leverage his legal background and experience to provide unique insurance and financial planning advisory services to help them design innovative and strategic approaches to their Executive Benefits products. Scott joined the insurance industry in 2006 specializing in insurance reviews and insurance planning for high net worth individuals. He also focused on executives of private and publicly held businesses, and employee benefit enrollment programs. Prior to that, Scott practiced corporate securities law in Manhattan.

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