What's This Problem That I AM Reading About Universal Life Insurance?

Yes, there is a serious problem: Many non-guaranteed universal life insurance policies are expiring prematurely.

This problem appeared because of sustained reduced interest rates, and inattention on the part of the owners who didn't know they should have increased their premiums over the years.

The problem can only be corrected when individual owners prompted by their advisors realize that life insurance must be actively managed as would any other stock, bond or real estate.

Have you ever discovered a bank entry error in your check register, resulting in a balance $100 or $1,000 less than what it should be?

Imagine how much worse you would feel if your or a client's life insurance policy worth $1,000,000 or more that you thought would be available to a spouse, child or others upon death was rendered unavailable due to a technicality.

As baby boomers age, the percentage of life insurance policies in danger of lapsing is on the rise and is creating a fertile environment for allegations of breach of fiduciary duty for trustees and professional advisors.

Among the many reasons that a non-guaranteed universal life insurance contract should be reviewed is to determine how much longer the contract is expected to remain in force. Approximately 20-25% of life insurance contracts that were purchased over the last 25+ years are in danger of expiring years earlier than originally anticipated. These universal life or variable life insurance contracts, unlike their more expensive whole life counterparts, are not guaranteed to last for a lifetime because their performance was tied to an unsustainable annual interest rate, or an anticipated stock index, neither of which was guaranteed, nor materialized.

The problem is that few insureds nor their professional advisors are aware that their life insurance contracts are not guaranteed to last a lifetime and may expire while an individual is only in their 80s. The client and trustee often incorrectly assume that either the agent or insurance company is monitoring the situation to make sure the insurance contract will always remain in force, but that's not true. As a matter of fact it would be in the insurance company's best interest if after all those years of your paying the premium, it became exorbitantly expensive to maintain the policy and the death benefit had to be reduced, surrendered or lapsed.

There are three reasons causing this problem today.

1. Reduced, Sustained Interest Rates

We have been in a historically low interest rate environment for an extended period of time. This has resulted in all insurance companies crediting a significantly lower rate to their insured's policies today than had been the case in the early 1980s when interest rates reached a high of 21%.

Between 1982 and 2016, carrier non-guaranteed current crediting rates for in-force universal life policies have declined from the 14% level to the 3% level.

2. Neither Interest Rate, Nor Death Benefit Guaranteed

In the mid-1980s, when prevailing interest rates averaged in the 14%-15%, range there were only two types of life insurance contracts: term life insurance, in which a specific dollar amount of life insurance was guaranteed to remain in force for a specific period of time at a specific guaranteed premium; and whole life insurance, which was guaranteed to remain effective for the entire life of the insured. These whole life contracts contained an accumulation account known as cash value, which was typically earning 3% annually. The cash value was available to be withdrawn and used for any purpose, so long as the owner paid a contractual 5% interest charge on the money that was borrowed/withdrawn.

For example if a whole life contract had an accumulated cash value of $100,000 earning 3% interest, the owner had the ability to borrow the money at 5% and then place those dollars in a money market or savings account, where they could have earned 15%. Thus, without any additional risk, the owner would be able to earn an additional 13% annually on their $100,000 of cash value.

Due to the competition from banks' paying significantly higher interest rates, the insurance industry watched billions of dollars in their cash value coffers being withdrawn and transferred to the individual bank accounts of the people it insured. In order to stop these outflows, in 1983 a life insurance subsidiary of E.F. Hutton created a new product called "universal life insurance." This life insurance policy paid an interest rate based on prevailing market interest rates instead of a fixed rate, as had been the case in whole life contracts. If interest rates rose, then one's insurance coverage would become less expensive or last for a longer period of time as a result of the increased accumulated cash value. What was not as clearly understood, however, was that if interest rates decreased, then the length of time the coverage would remain in force would consequently be reduced unless an increased annual premium was made to prevent the policy from expiring earlier. In other words, the universal life contract provided no guarantee as to how long it would remain in force. If interest rates maintained their projections, everything was fine, but if interest rates fell below their assumed projections there would be a problem.

3. Inattention on the Part of the Owner of Policy

The problem faced by many insured's today materialized from the fact that neither they nor their trustees -- usually an eldest child -- nor their advisors realized that life policies needed to be monitored and actively managed just like a stock and bond portfolio. Nor that they were 100% responsible for the performance of their life policy which included the duration of time the policy would remain in force.

While this interest-sensitive product stopped the tremendous outflow of monies from the insurance industry's cash value coffers to the banks, the solution was not in the best interest of the consumer as they are now dealing with life policies that are expiring prematurely.

How can the Problem be Resolved?

The only way this continuously growing problem that insidiously affects 45% of the non term Insurance purchased over the last 25+ years will be slowed down is when a client's advisor makes the client aware of the problem. Unfortunately not many investment, legal, nor financial advisers have chosen to address this growing concern. And until an adviser who maintains an ongoing trusting relationship with their client's overall financial wellbeing, regardless of whether they are considered a "Fiduciary" or not, steps up and inform their client that some of their life Insurance policies may be expiring prematurely, the problem will continue to grow.

The fact that many policies aren't sufficiently funded to last a life time because owners didn't know that life policies needed to be managed is secondary as compared to the fact that action needs to be taken to prevent the continued loss of a client's life Insurance legacy intended for the next generation. An Investment advisor managing a significant portion of a client’s investible wealth would be in an ideal position to do their client a great service if they requested basic life Insurance policy information data during one of their annual "Client Review Meetings". This would work well assuming the Investment adviser had an experienced independent trusted life Insurance source they're comfortable working with. One that in addition to doing the right thing for the client, would also be sensitive to the Investment adviser’s fear of endangering the adviser's current relationship with that client. The ongoing sensitivity to both issues could allow such a relationship to flourish on an ongoing basis. Point is someone has to initiate the conversation and ask the client "When was the last time your life Insurance portfolio was reviewed"?

Such a review can best be performed by an independent consultant experienced in that marketplace. This would normally include an actuarially based policy review that examines the actual historic interest rate return earned each year since the policy was purchased and actuarially determines exactly how long the contract will last based on (1) current crediting rates, (2) the current age and health of the insured and (3) any outstanding loans. The more advance notice an insured or trustee has about a potential shortfall, the more options are available to solve the problem often requiring less of an additional cash outlay.

Other important policy review considerations:

Is the life insurance contract you currently have competitive in terms of maximizing the death benefit and guaranteed duration compared to other policies available at a similar cost?

Are the people chosen as beneficiaries and their percentages of proceeds still in line with the insured's current objectives? These and other overlooked points are often discovered when a review is done.

Does your life policy allow the option of withdrawing tax-free dollars from the death benefit of a policy to pay for long-term-care expenses?

Barry Hunter
HunterLife
261 Yonah Rd
Toccoa, GA 30577
(706) 476-5393
Hunterlife.ga@gmail.com
www.hunterlifega.com