Universal Life Insurance: Past its Prime?

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In a 1980s TV commercial, Charlie Brown extols the benefits of universal life insurance. It "means the cash value of your insurance earns interest at competitive market rates," he tells Linus. "Within limits, you can skip payments or vary the amount of coverage." So persuasive was this type of simple sales pitch for a relatively new product that by 1985 universal life, or UL, accounted for some 38% of all individual life premiums, as measured by the LIMRA.

Between 2 million and 3 million UL policies were sold annually in that decade. But now, 30 years later, many of these policyholders may be feeling a kind of buyer's remorse. "UL as sold has backfired for many," says Larry Rybka, president and CEO of Valmark Financial Group in Akron, Ohio. "With interest rates as low as they are, UL is not the best insurance option for most people today.

That's because universal life invests part of policyholders' premiums in tax-deferred savings accounts, called "cash value" accounts, that are linked to interest rates. In the 1980s, when interest rates were high—even into double digits—those savings accounts could accrue a decent gain. The cash value could be leveraged to lower premiums or even, in some cases, allow policyholders to skip premiums every now and then.

Over the past three decades, though, interest rates have plunged. That's affected all insurance carriers, but it's been especially painful for universal life policyholders.

Interest Rates

"In the 1980s, universal life emerged as a result of consumer demand for an affordable, more customizable permanent insurance alternative to whole life," explains Stafford Thompson Jr., senior vice president of life product management at Lincoln National Corp., a leading provider of policies. "For those [clients] where universal life is a fit, these types of policies offer value, including a guaranteed lifetime death benefit for heirs, flexible premium payment options and an opportunity to accumulate savings in a tax-deferred manner." In essence, universal life is a variation on low-cost term coverage: You buy a policy that covers only a specific period of time. You renew it annually. Whatever gains the cash account accrues help offset the cost of successive annual renewals. Following the crash of 2008, the Fed slashed rates to near zero. Fortunately for policyholders, many universal life plans don't allow their cash accounts to fall below a certain threshold, typically 4%. But to make up the difference, carriers were forced to raise premiums—on top of the fact that premiums rise as policyholders age anyway.

Flexibility Can Be Complicated

"Universal life has backfired for older Americans for several reasons," says Richard Harris, managing member of Richard L. Harris LLC, in Clifton N.J. "Based on current interest rates, the policies are underfunded." What's more, he notes, universal life policies offer a high degree of flexibility that makes them more complex than anything Charlie Brown (or anybody else) could explain in a 30-second pitch. In short, you can generally set your own payment plan, based partly on your budget and partly on your expectation for interest rates. You can deviate from that plan temporarily if need be. You can borrow against the value of your cash account, though of course it will diminish the account's earnings. "I like universal life's flexibility and transparency," says Glenn S. Daily, a fee-only insurance consultant in New York. "[But] some people have gotten into trouble by underfunding their policies. They have abused UL's premium flexibility. And some people in poor health have continued to pay the 'planned premium' [and] failed to take advantage of UL's flexibility to stop paying premiums." To manage a universal life policy wisely requires periodic monitoring and expert advice, which critics charge has often been lacking. "No one [is] servicing them and advising the client," observes Harris. Universal life, he says, has often been pitched with oversimplified, unrealistic projections. Customers haven't always adequately been informed that "an illustration is a projection that in most cases won't happen the way it is shown," says Harris.

In-force Illustrations

Not that insurance providers are necessarily to blame. "Insurers take fulfilling their promises made to policy owners very seriously," says Lincoln's Thompson.

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> "Most consumers shop [for] term life insurance with only price in mind, rather than verifying what conversion options may be available to convert to a permanent plan," **notes Steven Schacter, senior vice president at Chappaqua, N.Y.-based Forest Hills Financial Group.**
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> For those who can afford higher premiums, whole life may represent a more dependable solution. It offers lifelong coverage and guaranteed cash value. "Whole life, if structured properly, can be utilized as a wonderful asset class providing guaranteed, tax-deferred cash values that typically equate to a bond portfolio rate of return," **says Schacter.**

Treat Your Insurance Portfolio Like Your Investment Portfolio

"Everyone's situation is different," says Santolli. "The best advice always is for clients to treat their insurance like they treat their investments, with regular monitoring and reviews. If you can check your investment portfolio every day, and sometimes several times a day, is it unreasonable to review insurance policies on a quarterly basis? If clients did this, the number of distressed policies would be minimal. ... Clients and brokers need to do a better job."

Advisors can help their customers fashion a customized portfolio of coverage. "They can increase the funding or capitalization based on more realistic assumptions or, if they are healthy, they can exchange for newer products with better guarantees," says Herbert Daroff, an attorney and certified financial planner at Baystate Financial Planning in Boston.

"With proper assumptions and guarantees, there are very good products to choose from," he adds, noting that exchanging like insurance policies can be done tax-free under the Internal Revenue Code's Section 1035.

Universal Life Alternatives

Over the years, carriers have designed a number of universal life variations, such as guaranteed universal life (a.k.a. "no lapse" or "secondary guarantee universal life,") which has a fixed premium; variable universal life (VUL), which uses stock and bond funds in place of savings accounts; and indexed universal life (IUL), which allows policyholders to divide their cash account between a fixed account and an equity index such as the S&P 500.

Valmark's Rybka notes that guaranteed universal life policies "protect the consumer from the interest rate risk" and are often "the best option for someone looking for the lowest premium outlay.... It ends up being like term insurance to age 120."

Yet there are also cases where he favors variable
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For other clients, however, traditional term insurance—usually the least expensive option— remains the most appropriate one. "Term is a great deal and the right product for 80% of the people," says Rybka. "It is important to have the right amount of coverage first, and term insurance allows people to afford the right amount." Term is a kind of gateway insurance, a starting point for younger people or others with limited financial means. But it isn't permanent, and doesn't build cash value. Still, don't give up on universal life plans. "Starting today, with increasing interest rates, UL could be a fine part of a life insurance portfolio," says Baystate Financial's Daroff. "Buy now and benefit from increasing interest rates."