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FINANCIAL PLANNING PERSPECTIVES

DO YOU KNOW WHERE YOUR UNIVERSAL LIFE PREMIUMS ARE?

Do you know how your universal life premiums are doing?

Consumers are feeling the impact of the bear market and low interest rates in many ways, but one way they may not yet be aware of is the impact on their insurance policies.

Two of the most popular types of life insurance sold during the 1990s were universal life and its cousin, variable universal life. A universal life policy pays an interest rate, or "crediting rate," that varies from year to year, but usually is guaranteed not to fall below a minimum of, say, around four percent. With variable universal life, the investment component of the premium goes into mutual-fund-like sub-accounts, so what you earn depends on what the accounts earn.

Universal life policies allow you to change the amount of the premium or the amount of the death benefit depending on your needs and investment circumstances. Some consumers bought these types of policies believing that the premiums would "vanish" after a few years because investment returns would build up sufficient cash values to not only pay for the premiums until the policy matured, but against which they could borrow for college and retirement.

But the ability of a premium to "vanish," or at least remain steady, depends on the investment component doing as well as was projected when you first bought the policy. And that's where the trouble lies, warn financial planners. With market returns down from the late 1990s, and interest rates nearly scraping bottom, many universal life policies are badly underperforming. Unless you increase your premiums, the policy will either lapse well before you want it to or its cash value reserves will be far less than you intended them to be. In fact, some consumers are receiving notices to increase their premiums or potentially lose their policy. And those who have not yet received notices may find themselves with problems down the road.

An article in the July 2003 issue of the *Journal of Financial Planning*, "In-Force Policy Illustrations: A Financial Planning Tool," illustrates the problem. The authors provide the example of a

policyholder who bought a $100,000 policy in 1985 at age 36 designed to mature at age 95 with a cash value of just over $344,000. The premium was $400 a year based on a crediting rate of 11 percent and a minimum guarantee of 6 percent. The authors project that if the policyholder doesn't increase the $400 premium, the policy will lapse by age 65—30 years early!

In the article's illustration, the policyholder should have started increasing the premium immediately in 1986 as interest rates declined. By adjusting the premium annually to compensate for declining rates, eventually leveling off at $1,320 a year, the policyholder would have kept the policy on the original target.

The authors also illustrate the high cost of waiting to make adjustments. If the policyholder waited until 1998 to start adjusting premiums, the annual premiums would have leaped from $400 to $1,950, and total premiums paid over the life of the policy would have been 35 percent higher than if annual adjustments had been made as soon as interest rates started slipping.

If you own a universal life or variable universal life policy, and you've not checked on how your policy is doing, start by asking your insurance company for a current "in-force illustration." This will show how the policy will perform in the future under current market or interest-rate conditions.

Assuming the policy won't meet the targets as originally designed, you have several options. First, increase the premiums enough to meet the targets, if you can afford to pay the higher premiums.

Second, keep paying the current premiums but reduce the death benefit enough that the policy won't lapse. The problem here is that you may want to maintain that original death benefit because it fits your family's needs, so you may need to buy additional life insurance through a second policy, such as term.

Third, stop paying premiums and let the remaining cash value pay the premiums until the policy lapses. Meanwhile, buy new life insurance that might be a better deal for you. One of the risks here is that your health may have declined since you first bought the policy, so be sure you qualify for new coverage before dropping the old policy.

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