FINDING UNIVERSAL LIFE POLICIES THAT WILL REMAIN COMPETITIVE

By Peter Katt

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Universal life insurance, developed in the late 1970s and early 1980s, has been very popular for two reasons. First, it is a permanent life insurance policy that unbundles life insurance pricing so that the cost of insurance, primarily mortality expense, and interest earnings, are easily identifiable. This distinct pricing of components allows for considerable premium flexibility. Second, unlike various forms of whole life that require a specific premium payment to be made either out-of-pocket or from dividend credits or policy loans, universal life premiums are only required if there are no sufficient cash values to pay the current cost of insurance, or large premium payments (subject to federal guidelines) can be made in which the amount not needed to pay for current cost of insurance earns interest at the current rate. The importance of this second reason can be understood by remembering that non-participating whole life sold before the early 1980s was based on fixed premiums and policy values where performance had become terribly non-competitive as interest rates were soaring and mortality improvements were being verified, because these whole life policies' fixed values were based on much lower interest rates and higher mortality expense. Indeed, universal life was promoted as the only life insurance policy consumers would have to buy, because its pricing components would always remain current.

However, for far too many universal life policyholders, the promises of the 1980s have not come true. During the past several years, I have seen a remarkable number of universal life insurance policies that appear to be overpriced, relative to current pricing conditions, which is not the understanding consumers had when they bought their universal life policies. By overpriced, I mean it appears that interest crediting is below market rates, and the cost of insurance appears to be above current mortality experience.

There are probably two reasons why some companies' universal life policies sold primarily during the 1980s are unfairly priced today. First, in order for some insurance companies to offer more competitive universal life policies to new customers, they may be squeezing out performance from their older universal life policy series by diverting some interest crediting basis points from old to new and hiking the mortality costs on the old in order to charge less for the new. This, of course, creates a conflict with existing policyholders, who in good faith purchased their universal life policies expecting future performance based on current pricing. Another possible reason why some existing universal life policies appear to be underperforming is that insurance companies may be looking to be acquired by other companies and want to boost their per policy profitability, so down goes the interest crediting and up goes the mortality costs.

Of course, many agents are well aware of which universal life policies are no longer competitive, and they may encourage existing policyholders to replace their older policies; this, though, involves hefty first-year sales commissions on the new policy, which cuts into the policyholder's bottom line. In addition, over time, a higher proportion of the healthy insureds leave the less

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competitive universal life policy series, leaving a higher proportion of less healthy insureds still owning the undesirable universal life policy series. This creates a self-fulfilling prophecy: Mortality costs do start going up because of this adverse selection. Joseph Belth, editor of The Insurance Forum, calls this the *death spiral*.

Am I expecting too much from universal life policies? I don't think so. For example, Ameritas' and USAA's low-load universal life policies are the same ones these companies have sold going back to the early 1980s. That is, all low-load universal life policyholders (new and old) with Ameritas and USAA are getting the same interest crediting and cost of insurance regardless of when it was purchased. This is keeping the faith with their policyholders because the major selling point for universal life has been that policyholders would receive market interest crediting and current mortality experience throughout the life of insureds.

The easiest way to determine whether your universal life policy may be overpriced is to compare it with low-load alternatives from Ameritas (their direct-to-the-consumer subsidiary, Veritas, can be reached by calling 800/552-3553) or USAA (800/531-8000). Both of these companies price their universal life policies based on realistic current pricing factors, so a comparison should yield a fair result. The method for making such a comparison is to assume the transfer of the current universal life policy's cash values to an Ameritas or USAA policy plus identical future premium outlays. If the Ameritas or USAA projected policy values are much higher than the projected values for your current universal life policy, you may be pretty sure that the current pricing of your universal life policy is not competitive, and a low-load replacement may be in your best interest.

If replacement is the solution, keep in mind that a new policy has a two-year period during which misrepresentations during the application process can be contested and no benefits are paid if death is due to suicide.

If you are no longer in good health, making a replacement with a low-load universal life policy may not be advisable because of the higher substandard mortality costs, and you will have to accept the unexpected poor performance of your universal life policy. As a last resort, you may want to consider litigation.

NEW POLICYHOLDERS

If you are purchasing a new universal life policy, detecting whether the insurance company you are considering uses such practices as launching new policies at the apparent expense of older policy series can take some research. For instance, late last year I examined the universal life policy from an insurance company with excellent financial strength ratings, and the illustration appeared generally to be offering reasonable projections based on current pricing conditions. However, I discovered that this company's current universal life policy series is its third since 1987, and the first two series are no longer being promoted. Currently the newer universal life policy has higher interest crediting and lower mortality costs than the previous two. Significantly, the first two universal life policy series had market levels of interest crediting until 1995 when they began receiving interest crediting that was 75 to 105 basis points below the newer universal life series. And the newer universal life series' mortality is some 15% lower than that of the older two. Combined pricing differences between the new *competitive* universal life policy series and the now obsolete universal life policy series produced projected policy performance differences of about 23%. The obvious question was: Will this company do to the new universal life series policyholders what it has done to their old universal life series policyholders?

There are life insurance companies that treat their universal life policyholders fairly by continuing to credit interest at current rates and to debit the policy cost of insurance based on current mortality experience. But there are also companies selling universal life policies whose treatment of policyholders is disgraceful.

Make sure you know which kind of company you are dealing with before you make the purchase decision. ✦