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Innovating Whole Life Insurance Policies

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Life insurance products have experienced considerable evolution over the past 30 years. Prior to 1980, clients essentially had two product choices – term and whole life. Since then, numerous new products have been developed with different features designed to meet each client's specific needs. These features include:

- Guaranteed death benefits
- Flexible funding and benefit structures
- Long-term care benefits
- Control over the investment strategy of policy values
- Extended maturity options to provide true lifetime benefits

We will use a few case studies to highlight some of the ways we have worked with clients to increase the value of their whole life insurance policies using newer, more innovative product designs.

Isn't Life Insurance Cheaper at Younger Ages?

Many clients are unaware of the alternatives they have to leverage newer product designs and innovate their older life insurance portfolios. We often hear that life insurance is "cheaper" at younger ages so they question the value in updating a product that was purchased 10, 20 or 30 years ago.

While it is true that life insurance expenses are typically lower at younger ages, there are two reasons the pricing may be better using new products:

1. Insurance companies update their pricing assumptions to reflect longer life expectancies for new products – in most cases, existing policies still incorporate the old pricing.
2. Mortality tables now extend to age 120 – this means the policy's expenses are amortized over a longer period of time resulting in potential pricing advantages.

Case Study 1 – Reduced Premium

There are several reasons to update a life insurance portfolio and cost is often high on the clients' list. In some cases, they want to reduce their annual cost, and in others, they want to stop paying premiums altogether. In this example, a client had an existing whole life insurance policy that was purchased 8 years earlier. The original strategy was to pay $108,000 annually for 10 years and then stop premium payments. Based on the original assumptions, there

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would be sufficient cash value in the whole life product at the end of the tenth policy year to maintain a lifetime death benefit.

During the eight years the policy was in-force, the dividend crediting rate dropped from 7.50% to 5.60%. As a result, the premium duration required to maintain a lifetime death benefit was extended from ten years to thirty-two years – more than triple the original expectation.

Updated pricing in the marketplace allowed the client to maintain the coverage and pay premiums for a total of 17 years – 15 years less than the existing whole life policy. The result is total premium savings of more than $1,620,000 over the life of the policy.

Updating the policy secured the death benefit and reduced the illustrated premium by more than $1,620,000.

Case Study #2 – Extended Maturity

There is a myth in the life insurance industry that it is too late to buy insurance after age 60 or 70. Pricing enhancements summarized above are one advantage to updating older life insurance policies. Another reason is to extend the coverage. Most life insurance policies purchased in the 1980s and 1990s mature prior to age 100 – often at age 94 or age 95. This means the life insurance company will pay the policy owner the cash value at that time which could be considerably less than the death benefit. In addition, any cash value in excess of the premiums paid is taxed as ordinary income.

To address this, the older policy can often be updated to a new design that defines maturity at age 120 and also includes a rider that extends coverage for lifetime. As an example, an 80 year-old female in good health had a whole life policy that was performing reasonably well but had a defined maturity of age 100 at which time the insurance company would pay the cash value to the policy owner and any gain would be taxable. To avoid taxes and maintain the desired death benefit, the policy was updated to a policy with maturity at age 120.

Updating the policy secured the death benefit beyond age 100 and avoided a potentially adverse tax situation.

Case Study #3 – Investment Diversification

Life insurance products rely on a number of assumptions including expected mortality and policy persistency. One of the most important assumptions is the illustrated rate of return. Whole life policies rely on the insurance company to invest the accumulated policy cash value into their general account. The insurance company then incorporates various components such as administrative costs, mortality costs and their experience to determine the declared dividend rate. Because all of these variables are combined, it is difficult to determine what the actual insurance expenses are.

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Because the insurance company is taking the investment risk, their general account is typically invested in highly-rated corporate bonds. Over the past 30 years, this has been a reasonable strategy. But as financial markets evolve, many clients are looking for opportunities to allocate their accumulated cash value across different asset classes.

In one example, a client had a whole life policy with a dividend crediting rate that had declined more than 300 basis points in the past decade. As a result, the life insurance policy was under-performing and was becoming difficult to maintain. The client updated the policy to a product with multiple investment alternatives that transferred the investment control (and investment risk) to the owner.

The benefit of more investment flexibility combined with improved pricing and premium flexibility created long-term value for the client's beneficiaries.

Summary

Whole life products serve a valuable role in life insurance planning but have design features that may not be the best fit for many planning needs. Newer products such as No-Lapse Guarantee, Universal Life, Indexed Universal Life and Variable Universal Life offer more flexibility, enhanced investment control and pricing transparency.

Life insurance is a critical element in long-term financial planning and existing policies should be pro-actively managed to ensure they are meeting the client's needs. The administration of a life insurance policy should include updated illustrations to reflect current assumptions and ideas to maximize the value of the policy.

Everybody has unique circumstances and objectives. With proper planning and product selection, a life insurance portfolio should be able to meet unexpected changes in the marketplace and in planning goals.

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