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Is Your Life Insurance Performing As Expected?

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VIEWPOINT

Are you overpaying for your life-in- surance policy, or is your policy underperforming? If you haven't reviewed your policy in the past 10 years, the answer is probably *yes*.

Like most products, life-insurance policies are constantly evolving and improving. Over the last 20 years, there have been dramatic changes in both policy design and pricing. Intense competition among life-insurance companies, increased life expectancy, and better underwriting have driven the cost of life insurance down. Consumer demand and agent input have helped change the policy design as well to give the consumer more options to better meet different needs.

In addition, many cash-value policies that were purchased 15 or 20 years ago were purchased when policy-interest rates were 12 percent to 15 percent. With interest rates declining over the past 15 years to historically low levels today, many, if not all, of those policies are not performing the way they were projected to perform. In fact, many of those policies are in jeopardy of lapsing, or running out, prematurely.

So what should an individual or business do? Review your policies. While most employers review their property, liability, and health-insurance coverage every year, many don't give the same attention to their life-insurance policies. A review will help you determine if you can salvage your existing policy by making some simple changes, or if you should consider an alternative policy to better meet your needs.

Whether acting on behalf of your company, or yourself, it makes good business sense to review your policies to determine if they are providing the benefits that you think and expect that they are. In fact, if acting on behalf of others, or acting as trustee of a plan or a life-insurance trust, you may have a fiduciary responsibility to review those policies.

A basic review should answer the following questions about your coverage. How much coverage do you have? What type of policy is it? What is your annual premium? Is the premium level? What is the purpose of the coverage? How long was it supposed to last? How long is the company projecting it will last? Is it to fund a buy/sell agreement? Is it key employee coverage? Is it for income replacement or debt reduction? How was the amount determined? Is the policy building cash value for a deferred-compensation arrangement or a supplemental retirement plan? Once you've answered some of these basic questions, you can dig deeper into an analysis of how the policy is performing and determine if you need to make changes.

Oftentimes, the review is simply going to refresh your understanding of what you bought and reassure you that it is performing as intended. But in other cases it will bring to light the fact that changes need to be made.

Along with considering changes to your existing policy, you should also look at some of the newer policies now available. Advances in medicine and healthier lifestyles mean that almost everybody is living longer. From a life-insurance standpoint, this translates into lower costs of insurance and lower premiums. Add to the mix intense competition among life-insurance companies, and you may be able to purchase a policy today for less than you paid when you purchased your original policy, especially when it comes to term insurance.

In 1994, a 47-year-old, non-smoking female in good health bought $100,000 of 10-year level term insurance for $294 per year. Today, a 47-year-old female can buy a 10-year level term policy for only $149 per year, or less. That's almost 50 percent less than 1994. In fact, that same female can buy $100,000 of 10-year level term insurance today, at age 57, for only $260 per year — less than she paid 10 years ago at age 47.

But what about cash-value life-insurance policies? Many of these rate decreases have been passed on to cash-value life-insurance policies as well and are being reflected in new policies coming on the market today. In the past, if you wanted life insurance for the rest of your life, your only choices were whole-life insurance or universal life. Whole-life offers guaranteed death benefits to age 100, but carries significantly higher premiums. These higher premiums also generate substantial cash values that can be used for any and all reasons in the future. For many people whole-life still offers the best long-term value.

However, not everyone is willing or able to pay the premiums for whole-life. Universal-life allows an individual to have a cash-value life-insurance policy at a lower premium than whole life, but without the guarantees. If interest rates remain high enough and the cash values are sufficient in the future to offset increasing costs of insurance, the policy will remain in effect. If not, it will lapse, or require much higher premiums. Policies purchased back in the late 1980s assumed long-term interest rates of greater than 10 percent. With interest rates as low as 3 percent today, most of these policies are facing significantly shorter coverage periods, and in many cases, the insured is not aware of the deterioration of his policy.

In recent years, insurance companies have introduced a new breed of universal-life policies with guaranteed death benefits. These policies allow you to choose how long you would like your death benefits to be guaranteed. With lower costs of insurance and better underwriting, many of these policies allow the insured to purchase a policy that is guaranteed to age 100 and beyond for less than traditional universal-life-insurance policies and far less than whole-life insurance. In fact, these new policies are being used to rescue many of the policies purchased years ago at about the same or lower premium than the original policy.

In a recent case that we reviewed, a 56-year-old business owner had purchased $525,000 of universal-life back in 1986 with an annual premium of $4,635. At the time of purchase, the interest rate was in excess of 12 percent. The policy projections showed an increasing cash value all the way out to age 100. With interest rates declining over the last 18 years, the insurance company was now projecting that the policy would run out of cash at age 74 and coverage would be lost.

As part of our analysis, we looked at alternative policies. We considered using the existing cash value of $46,000 to purchase one of the newer guaranteed universal-life policies. With the transfer of cash value, the owner was able to purchase the same $525,000 of death benefits for just $3,500 per year. Not only is the premium lower, but the new policy is guaranteed to age 100. While not all cases result in savings of this magnitude, it is just one of dozens of cases where we have been able to rescue a failing policy with one of the newer policies available today.

In this case, the primary goal of the business owner was to have death benefits for the rest of his life. His goal was not to build cash values to fund deferred-compensation or supplemental-retirement income. If the goal was to build cash value, we would have considered other alternatives.

With lower premiums and new products on the market, the insurance industry is offering all of us an incredible opportunity to review our life insurance and improve our financial situation to make sure that those we love are taken care of. Don't wait until it's too late to make changes. In other words, you must be in good health to purchase life insurance. Once you're dying and realize you need coverage, it's too late to get it.

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