



# Will You Outlive Your Life Insurance?

Bruce Cappon

**L**ower than expected investment returns can put long-term life insurance policies at high risk of premature lapse.

If you purchased permanent Life Insurance for estate purposes tied to investment returns, it's critical to find out whether you will outlive your insurance coverage. Where scheduled premium levels based on projected investment performance at the time of issue failed to materialize, are you aware that minor variances could threaten the long-term sustainability of the coverage?

## Which Type Of Permanent Life Policies Are At Risk?:

- **Non-guaranteed Universal Life (UL); and**
- **Traditional Whole Life Participating plans.**

Both of them can have aspects, which are tied to projected levels of underlying investment performance. This article will concentrate on the affected Universal Life (UL) policies. A subsequent article will focus on Whole-Life Par.

Universal Life insurance can be a very effective form of permanent life insurance. Its primary purpose is to provide funding on death of the insured to cover long-term estate or business needs.

“Term Life Insurance” is generally suitable to cover more temporary short-term requirements. The initial premiums are lower than for permanent life plans.

UL has unequalled flexibility to meet changing financial circumstances compared to its predecessors, which contained more structured terms and conditions. The purpose of this article is to provide advice to UL policyholders in assisting them to identify policies at risk and secondly utilizing the policies' advantageous adaptability by taking the required steps, if necessary, to conserve the contracts from premature lapse.

Failure to do so may result in a) the policy not meeting its intended financial goals and b) the ultimate cost could greatly exceed the premium compared to less expensive Term Life purchased from the outset.

Astonishingly, what was originally estimated to be a 10-payment policy may now indicate a need to stretch those payments out to 40 plus years. Figure 1 demonstrates how a spread of 4% on return can drastically effect the payment period, i.e. at 8.5%, the policy payment period is 10 years; at 6.5% it is 23 years; at 4.5% it is 50 years.

Depending on the severity of the circumstances, taking prompt pre-emptive action may put your policy back on track. The first step is to determine whether your particular policy is at risk of premature lapse. This information is not readily forthcoming from your “Policyholder's Annual Statement”. You may have dutifully filed those away each year in a drawer. In any case, this statement reveals only a static picture and is about as purposeless as having a colourful roadmap in hand without knowing your current location.

I suggest you use this annual paper-prompt to request an updated sales illustration called an “in force policy il-

lustration". A revised illustration is your policy's "GPS" revealing where you are now, where you are going and whether you'll make it to your desired destination. Absolutely insist that the illustration show the (optional) column for year-to-year mortality charges.

Remember the detailed sales illustration you received at the time of purchase and stored away with your policy? Now is the time to retrieve and compare it to the results of the current one.

## Beware Of Overly Optimistic Projections

It's crucial that U.L. policy-owners understand that their insurance company's generated projection has been based on a gross rate of return. In reality, the insurer will deduct relevant Management Expense Ratios (MERs) to arrive at your actual credited rate.

For example, if your policy illustration was based on an 8.5% assumption and your MERs are 3%, you'll need to gross 11.5% to validate 8.5% net results projected by the illustration. Is this too optimistic? Discuss assumptions with your advisor. The range of 4% to 6% may be appropriate depending on the underlying investments.

Moreover, if your investment returns are tracking particular underlying mutual funds' performance, understand that MERs have already been paid. Verify if you are paying additional management fees directly to the insurer. If so, your returns may be devoured by fees. In this case, you'll have to further net-out the return or consider revamping your investment allocations.

Another factor to consider is that some U.L. policies may have included projected bonuses, which were predicated on market performance. If these fail to materialize, this too can significantly impact your policy's long-term sustainability.

The reason policies lapse prematurely is quite simple: the premiums you're paying (if applicable) together with the cash values accumulated in the contract are insufficient to fund your ongoing mortality costs required to age 100 (or beyond with certain policies). As with driv-

ing a car, the sooner you recognize a dangerous situation ahead, the greater the options to break or swerve to avoid a possible catastrophe.

## Which U.L. Policies Are Vulnerable?

Policies most at risk are those where the mortality (Life Insurance) charges are based on increasing Yearly Renewable Term costs (YRT) rather than the level "Term to 100" mortality costs (T100).

Negative results would be exacerbated if you paid a single sum or had shortened premium deposits flowing through an adverse investment period. It may not be immediately obvious to the consumer which type of mortality charges apply to their policy. If you're unsure, ask your agent/insurer for clarification. Many policy-owners wrongly assume that their underlying mortality charges are necessarily level because they are paying level fixed premium deposits.

The face page of your policy will indicate what type of mortality charge you are paying. If your annual statements indicate an increasing cost of mortality, you likely have the YRT version.

Policies that combine lower than anticipated investment returns with increasing Yearly Renewable Term insurance (YRT) costs are hit with a double whammy. You'll often find that in these circumstances the policy may not regain its long-term viability even with the rosiest of market recovery. The reason being that the original overly optimistic illustration at higher projected returns may have resulted in the investment Fund Value at the older years equalling the Face Value (life insurance value) of the policy. In this rosy scenario there would be no further mortality expense charges.

A weaker than anticipated investment performance would result in significantly increasing mortality charges. These can skyrocket at older ages draining the investment fund. The result: having to fund these ever increasing charges "out of pocket" (See Figure 2). **For example, annual funding would be required at age 65, 75, 85, 95 respectively of \$2,,675, \$8,315, \$26,285 and \$41,512.**

Again, your personal in force ledger will illustrate your year-to-year cost of mortality.

Depending on original investment assumptions, policies, which are based on level T-100 cost of mortality could also be at risk of running dry of cash if the scheduled premium deposits were calculated for limited pay period (non-lifetime) i.e. 10-pay, 20-pay, etc.

The saving grace of these policies is that if they do go offside, in the worst case scenario the policyholder could conceivably continue to fund the level charges out of his wallet.

## What Are The Solutions?

The following solutions could be taken into consideration in conjunction with adjustments for higher premiums, longer premium durations and Death benefit reductions:

1. Let the policy run until it lapses or pays the Death Benefit;
2. Pay required short-funded premiums out-of-pocket;
3. If your policy has increasing YRT mortality costs change to level T-100 cost of insurance charges. This can often be an excellent alternative. Some policies do provide a non-medical exchange but there may be either age or duration deadlines.
4. If insurable, subject to caveats below, replace for a new permanent or term policy:
  - Consider the replacement contract will have a new two-year suicide and Incontestability clause;
  - Do not drop your policy without having your new policy in full force;
  - Consider differences in long-term guaranteed interest rates, MERs, bonuses; Contractual minimum guaranteed lifetime GIC rates on older policy versions may be as high as 4% to 5% with upside potential. Should you lock-in some or all of your investment values at these rates?

- Consider the impact on surrender of a possible tax gain based on the adjusted cost basis. Don't assume because returns have been poor that there is no tax liability;
- Will there be new surrender charges (cash value shrinkage)?

5. Reinvesting the Fund Value in a Segregated Fund (Self-insurance). This may be a feasible option for those who are uninsurable and in other circumstances. The Seg-Fund may be treated for tax purposes and liquidity as Life Insurance in the event of death and may also have special provisions relating to creditor protection. This may be a better option than simply eroding a policy's capital to zero consequently leaving nothing to your beneficiary. Consider the appropriateness of a Seg-Fund with 100% death benefit guarantee and low MERs. Although the growth of the Seg-Fund may never equal the former Life Insurance face amount, at least some funds will be salvaged and grow rather than being depleted prematurely.

6. Would a "Joint and Last Survivor" policy suit your current estate needs? If so, the mortality charges could be reduced by 50% or so compared to a Single Life insured.

## Independent Advice:

If you do not have a trusted agent, consider engaging a policy evaluation specialist. An advisor who will independently examine all possible solutions within the existing policy framework or if it is in your best interests recommend replacement .

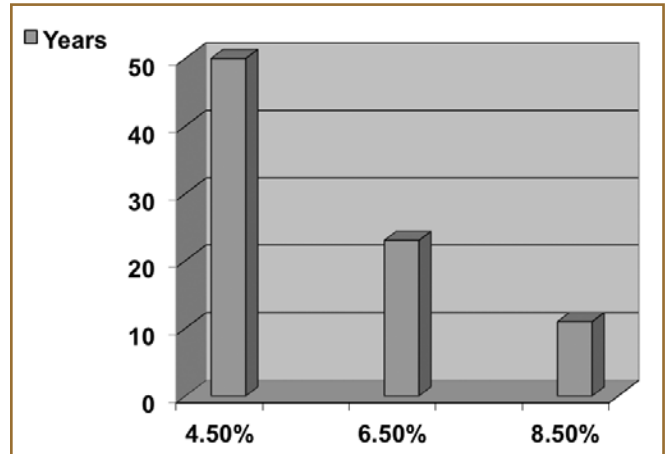
You may obtain independent advice by paying a flat fee perhaps offset by commissions if new insurance results.

The following charts on the next page are for general illustration purposes. These are based on current rates from a major insurer. Obtain a customized "in force policy ledger" for your specific policy. Your personal results could vary substantially from those illustrated.

### Figure 1 – Premium Payment Period at assumed Investment Returns

\$250,000 Universal life, male, issue age 50, life expectancy of issue age 84, non smoker, standard risk, no bonuses, death benefit plus fund value, YRT mortality charges.

The premium payment periods on the right are based on annual payments of \$7,361 at varying investment returns.



### Figure 2 – \$250,000 Universal Life, Yearly Renewable Term Mortality Costs

Rates illustrated increase annually however for conciseness purposes, the first 20 years are indicated thereafter they are illustrated every 5 years....for additional criteria see Figure 1.

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AGE	MORTALITY COST	AGE	MORTALITY COST
50	\$627	62	\$1,980
51	\$657	63	\$2,210
52	\$700	64	\$2,450
53	\$760	65	\$2,670
54	\$835	70	\$4,817
55	\$920	75	\$8,315
56	\$1,030	80	\$15,920
57	\$1,142	85	\$26,285
58	\$1,260	90	\$41,512
59	\$1,395	95	\$41,512
60	\$1,537	100	\$41,512
61	\$1,757		