Why Would My Life Insurance Policy Underperform?

A life insurance policy is made up of many components. These are the main factors that affect the performance of a life insurance policy:

1. **Interest/Dividend Rate credited** – On traditional (non-variable) Whole Life and Universal Life policies; the dividends/interest credited are based on the overall performance of an insurance company managed investment account. Performance of the company's investment performance is unpredictable and can negatively as well as positively affect your policy.

2. **Expenses** – these are the overhead costs – new business costs, commissions, underwriting expenses, etc.

3. **Declining Credit Rate Changes** — Twenty years ago, for most life insurance companies, the interest crediting rate was around 12% percent and currently the interest crediting rate is approximately 4.5% to 5% which was the guaranteed rate twenty years ago. Currently some companies pay a lower interest rate and most have a lower guaranteed interest rate than 4.5%. Most company's credit at a higher rate than their guarantee rate.

Example Of Declining Interest Rates On A Universal Life Policy

A Universal Life policy was issued with a large, well rated carrier on March 5, 1997 with a death benefit of $75,000. The annual premium of $1,172 with the assumed interest rate of 6.15% projected to endow (cash value = death benefit) at his policy age 100. In projections run on April 5, 2004; based on current assumptions, the policy will lapse (terminate) at his policy age 91. To have the policy endow (just 9 years later) at age 100, the annual premium would need to be increased to $1,379 – an increase of 18%. Keep in mind that the effects of a decreasing dividend scale on a whole life policy will have a similar effect.

4. **Cost of Insurance/Mortality Cost** – Also known as the risk charge. These costs increase annually

based a table in force on implementation of the new policy. This is the amount applied for the pure cost of insurance.

Example of The Impact Of Increasing Mortality Costs

The most noted and common impact on the performance of a life insurance policy is the interest rate as shown on the example above. The larger and usually unknown/nondisclosed impact is a change in the mortality costs. This impact is usually unknown to the policyholder as well as the agent. A change in mortality costs is much rarer than a change in interest rates as far as anyone knows. A tick in the interest rate has much less impact than an increase in the mortality rates. As an example, a policy owner with a large, well-known life insurance company faces an extremely bad situation due not only to decreasing interest rates as well as to increased mortality costs. The company was not willing to admit to the increased mortality costs; finally after a couple of calls and letters, they admitted a .25% (or so) increase in mortality costs.

Here's the effect on this policy: The policy was purchased on April 16, 1991 with a death benefit of $750,000 and an annual premium of $5,661. The assumed interest rate at the time was 8% (about average at the time). According to inforce illustrations dated 2/26/2001 (current weighted interest rate of 5.68%, the annual premium would need to be increase to $11,137. On January 7, 1999, an inforce illustration (weighted interest rate of 5.5%) showed an increase to $10,711 in the annual premium. According to inforce illustrations generated on May 12, 2005 (current weighted interest rate- 5.16%); if he continues to pay the annual premium of $5,661, the policy will lapse (terminate) at his policy age 81. If he wishes to continue the policy to his policy age 100, the premium would need to be increased to $13,805 annually.

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