

## At Witt's End

### Bear Market Bailout For Your Life Insurance Agent? July 2009

The recent bear market has had a tremendous negative impact on financial portfolios, but it's done even more harm to variable universal life (VUL) insurance policies. A vast number of inforce VUL policies are so damaged that even a rebound in the market may not get them back on track.

#### Why has the bear market potentially bailed out your life insurance agent?

Essentially, the bear market has helped wipe away culpability for a vast number of poor VUL purchase decisions over the last 10-20 years. It's easier to blame policy problems on the bear market rather than the original purchase decision. Some clients have come to us stating that "if only the market would have performed as expected, then everything would be fine." That is often untrue.

A large percentage of these policies were destined for failure **even in an average market** as described in our article in *The Insurance Forum* (<http://tr.im/urnn>). Even if the average market returns were equal to the originally illustrated rate and the policyholder paid all illustrated premiums since inception, **many of these policies would still die sooner than the insured**. This would result in zero benefit at the time of death unless significant corrective action was taken along the way.

**VUL policies are chronically under-funded** because sales illustrations fail to take into account market volatility. The failure percentages skyrocket if the average market returns are worse than illustrated and/or policyholders pay less into the policy than illustrated, both common situations right now.

#### Why is the negative impact greater on a VUL policy than on investments?

Whenever a VUL insurance policy has an account value that is less than what was illustrated, the cost of insurance (COI) charges will also usually be higher than what was illustrated.

Higher-than-illustrated COI charges further depress the account value, which further increases the COI charges, and so on, creating a downward spiral. Making matters worse is that mortality rates increase exponentially with age, so lower-than-illustrated account values become increasingly problematic with each passing year.

It is quite common for an under-funded policy to be in a state where better-than-illustrated investment returns going forward **cannot** get the policy back on track. Only significant policyholder action can revive the policy such that there is a high degree of confidence that the coverage will last for life.

#### What are my options?

If you are still in relatively good health, then you can **replace your existing policy** with a non-variable policy. But take into account any surrender charge implications on your existing policy,



and try to minimize agent compensation on your new purchase since you have likely already paid for this (at least) once.

You could opt to **reform your existing policy. But don't make the same mistake twice!** It's not enough to simply get your policy back on its illustrated track, because there is still an unacceptable risk of potentially devastating outcomes.

To have a high degree of confidence in your VUL policy producing its intended death benefit for life AND avoiding higher future premiums, you will need to significantly reduce the death benefit, perhaps by as much as 50 percent (and not every policy can even be restored to a satisfactory state).

You may also decide to simply **view your existing VUL policy as an investment.** Then you can determine if the existing policy can be modified such that the tax advantages afforded by life insurance are more valuable than the "drags" associated with COI charges and expense charges within the policy.

Any time you contemplate a death benefit reduction, be wary of pro-rata surrender charges during the surrender charge period. You will need to determine the optimal time to make that reduction.

We've assisted numerous national clients in evaluating their existing VUL policies and determining an appropriate course of action going forward. If you'd like to discuss these issues further, please contact us.

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