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Encore: Market Hits 'Universal Life' Policies
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Universal life **insurance** has grown in popularity thanks to its flexibility. But policyholders may not realize their coverage could be dwindling.

Universal life is considered permanent life **insurance**, yet it actually has an expiration date that's usually set past most life expectancies. But lower interest rates, a falling stock market -- or a combination of both -- may limit how long these policies remain in force.

Shoring up these policies may require handing over more money to your insurer or reducing coverage. Policyholders need to keep a close eye on statements for any changes.

"It can be just as important to manage your **insurance** policies as it is to manage your portfolio," says Robert Burger, a vice president at financial planners Lenox Advisors. With universal life policies, "you don't set it and forget it."

Universal life **insurance** generally falls in between the permanent coverage of whole life and the temporary benefits of a term policy. Unlike term or whole life, policyholders have flexibility with the amount and frequency of premium payments, after the initial payment.

However, with universal life policies, the length of time that coverage is in place can change mid-policy. It can vary depending on complicated math that factors in the amount of premiums paid, investment earnings and the size of the so-called mortality and expense charges deducted by the insurer.

Still, most policies are issued with the aim of lasting until a policyholder reaches age 95 or 100. (There are no-lapse policies, which guarantee lifetime coverage. But they have their own set of plusses and minuses.)

Universal life **insurance** comes in two flavors. In a basic policy, the death benefit and cash value can build just as with a whole-life policy -- by accumulating the premiums and dividends paid to the policyholder by the **insurance** company, which invests the premiums mainly in bonds.

Then there's the variable universal life, or VUL, policy. With a VUL policy, the holder chooses investments -- commonly stock mutual funds -- and those returns help create a policy's value. Higher projected returns on stocks can make it possible to get a bigger death benefit with lower premiums.

The catch isn't just the possibility of losing money in stocks. When a policy is issued, the stated premiums and death benefits are typically premised on the investments returning the same amount year after year. When the markets are volatile and don't live up to those expected returns, policyholders risk seeing their policies expire years earlier than they expected.

Scott Witt, a fee-only **insurance** adviser in New Berlin, Wis., has seen how the stock market's swings can set a VUL policy far off course. Take the case of clients who came to him after rolling $425,000 from another life-**insurance** policy into a VUL policy in 1999. With a 12% assumed annual return, the death benefit was $10 million and was expected to last at least through age 100, without the need for additional premiums.

For that to happen, the policy needed to have an account value today of $850,000. But thanks to the stock market's weak performance during the past decade and fees taken by the insurer, it's just $225,000, Mr. Witt says.

As a result, if the clients, now age 65, don't pay any more premiums, the policy could expire worthless when the clients reach age 78.

In order to get back to the original coverage, the clients would to need to pay premiums of $64,000 a year until age 100. If they didn't want to pay any more premiums, but wanted the coverage to last the rest of their lives, they could reduce the death benefit to $2.7 million. But neither would guarantee they wouldn't fall behind again if the stock market was to again post big losses. They also could switch to another policy, but the commissions could eat away at the remaining money.

"It's very punitive once you fall behind on these policies," says Mr. Witt.

Even basic universal-life policies are feeling the pinch as the lower long-term interest rates of the past two decades have reduced the dividends that insurers pay to policyholders.

On a whole-life policy, this merely reduces the available cash value. But on a universal life policy, it also reduces the length of coverage.

Consider a 70-year-old man who took out a universal-life policy with $500,000 coverage until age 100 when interest rates were at 8%. The policy assumed rates would stay at 8% during the first 10 years of the policy, but they actually fell to 5.5%. To maintain his coverage, the holder would have to increase his annual premium to $22,200, from $16,395.

Of course, should interest rates rise and stocks enter into a long bull market, these forces will reverse and benefit universal-life policyholders.

In the meantime, policyholders should give their statements a close read to see the status of their coverage. If it looks like it has changed, call your insurer or **insurance** agent to discuss what steps can be taken -- including running different scenarios for rebuilding coverage.
