UNPREPARED

Universal Life Insurance, a 1980s Sensation, Has Backfired

A long decline in interest rates caused premiums to soar when they were supposed to stay level

By Leslie Scism
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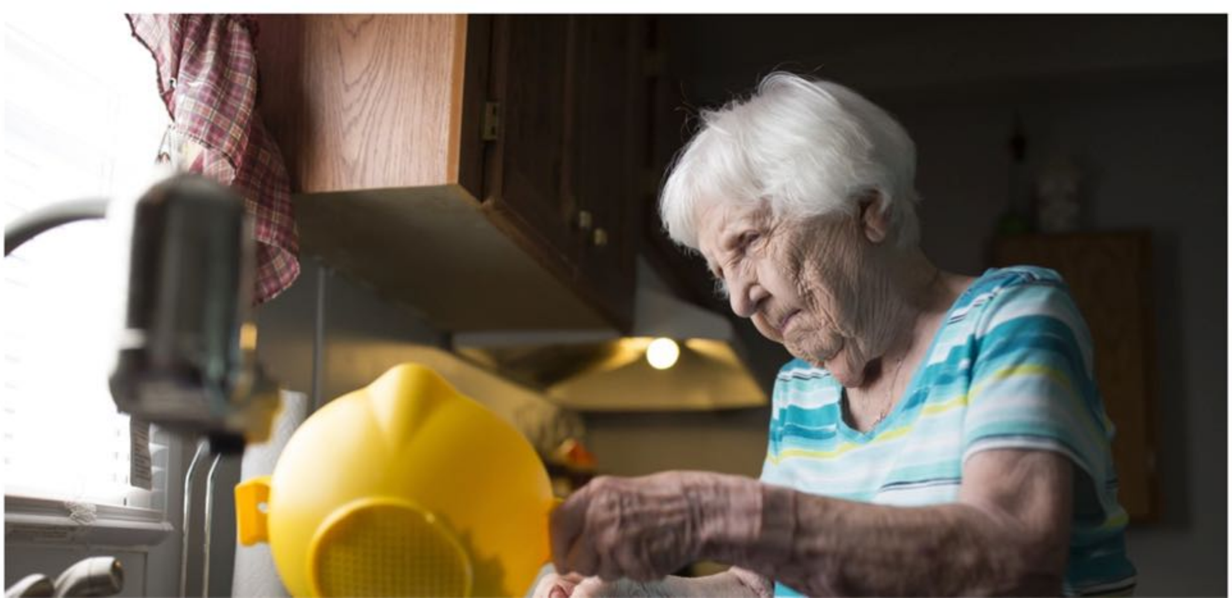
A popular insurance product of the 1980s and 1990s has come back to bite many older Americans.

Universal life was a sensation when it premiered, and for some years it worked as advertised. It included both insurance and a savings account that earns income to help pay future costs and keep the premium the same.

That was when interest rates were in the high single digits or above. Today, rates are completing a decade at historically low levels, crimping the savings accounts. Meanwhile, the aging of the earliest customers into their 70s, 80s and even 90s has driven the yearly cost of insuring their lives much higher.

The result is a flood of unexpectedly steep life-insurance bills that is fraying a vital safety net. Some find they owe thousands of dollars a year to keep modest policies in effect. People with million-dollar policies can owe tens of thousands annually. Some retirees are dropping policies on which they paid premiums for decades.

“I’m very scared that everything will go down the drain,” said Bernice Sack, a 94-year-old former hospital billing clerk in North Carolina.



Bernice Sack, 94, prepares goulash for dinner. Her prescriptions share a cupboard with spices in the kitchen of the house where she and her daughter Janet Amrine live. Mrs. Sack struggles with universal-life premiums that have jumped to $285 a month from $56 when she bought her policy. PHOTOS: MADELINE GRAY FOR THE WALL STREET JOURNAL(3)

A $56 monthly premium Mrs. Sack paid when she bought the policy 35 years ago has climbed to $285, despite her efforts to keep the cost down by reducing her death benefit. Living with a daughter and getting by on Social Security, she skimps on medications to pay the insurance bill, sometimes runs late on her share of household costs and considers ice cream a splurge.

undefinedJohn Resnick, co-author of an American Bar Association book on life insurance, said of hundreds of older policies he has reviewed over a decade, "easily 90% or more actually were in trouble or soon to be in trouble." Many people "are sitting on a ticking time bomb, and most probably aren't aware of it," he said.

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Universal life is among the reasons Americans are approaching retirement in the worst shape in decades. The insurance policy type emerged in an era nearly four decades ago when the Federal Reserve was fighting inflation with high interest rates. Some financial advisers suggested people forgo traditional "whole life" insurance and buy less-expensive policies that covered just a limited term, investing what they saved in the mutual funds and money-market funds then proliferating. Insurance companies embraced this mantra of "buy term and invest the difference" by inventing a new product.

With universal life, the customer buys a one-year term-insurance policy and renews it annually. In the early years, the premium the customer pays is a good deal more than the actual cost of the insurance. The excess goes into a tax-deferred savings account.

The policies are designed so the gains in the savings account, which the industry typically calls a "cash-value" account, offset part of the cost of renewing the term insurance each year.

Much depends on what interest rate the account is earning. When these policies first were sold, U.S. interest rates were unusually high, and insurers often illustrated the policies to potential customers using a scenario of continuous 10% to 13% rates.

A 1986 commercial for Metropolitan Life's Universal Life featured the Peanuts Gang.

Companies typically showed worst-case scenarios, too. But with high rates common, the worst-case scenarios often got short shrift.

The interest projections were proving unrealistic by the mid-1990s, and especially so after the 2008 financial crisis depressed rates. Although many policies didn't allow the savings-account return to fall below 4% or 5%, that wasn't enough for early customers. The cost of a year of term insurance soars once people reach their late 70s.

Compounding the problem, universal life offers flexibility that is alluring but dangerous. Within reason, customers plan their own monthly or annual premium payment. They can set it low, counting on high interest income in their savings account to keep the policy financially sound.

Customers also can choose to pay less than their planned premium sometimes if money is borrowing or skipping payments could undermine a universal-life policy.

How Universal Life Insurance Can Trip Up a Policyholder

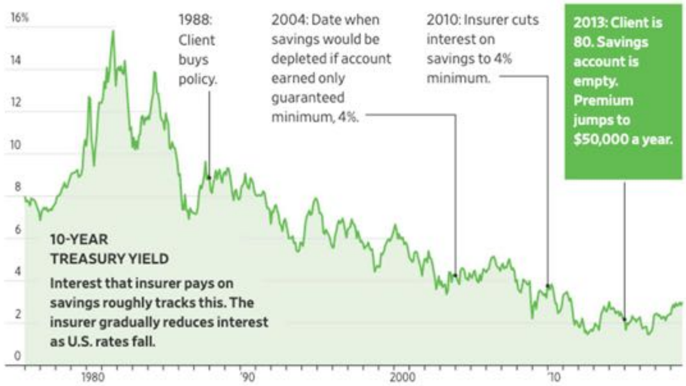
Clients buy with the expectation a policy's savings account will grow enough to help cover term-insurance costs as they age, keeping the premium level. This doesn't work if interest rates turn out lower than projected. Many don't realize starting rate isn't guaranteed for life of policy.

EXAMPLE

55-year-old buys a $1 million policy in 1988

Annual premium: $12,000
That more than covers insurance cost at first, and excess goes into savings account

Rate on account starts at 9%
Policy lasts until client is 100 in 2033 if rate is always 9%



Sources: John and Billie Resnick, the Resnick Group; Thomson Reuters (yield)

Defending their sales, insurers say they have paid out more than $150 billion on universal-life policies, and some owners received value from their policies by borrowing from them. Insurers stress that materials given to customers say only a minimum interest rate is guaranteed; higher rates used in sales pitches are hypothetical.

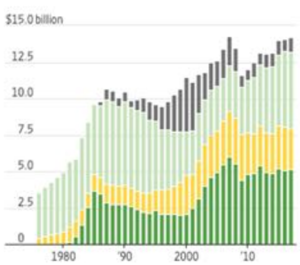
Insurers send customers annual statements showing the change in the value of their savings account and what it has cost to renew their term insurance. Some companies seek to identify problematic older policies, sending customers extra communications to be sure they understand their situation.

A New Type of Insurance

Universal life was initially a hit, but the original version lost favor as policies' savings vehicles earned less interest than projected. Varieties called guaranteed and indexed universal life were created later and became big sellers. Another category, variable universal life, invests clients' premiums in stock and bond funds.

Sales of new individual policies, by premium volume

Universal life* · Term life · Whole life and other · Variable universal life



*Includes guaranteed and indexed UL
Source: Limra

"Lincoln annually provides all policyholders with an updated statement that they and their agent can, and should, use to manage their policy and assess how various activities including withdrawals, missed payments and loans may impact its value," said Scott Sloat, a spokesman for Lincoln National Corp. , the company that sold Mrs. Sack her policy.

He said Lincoln sends additional letters to customers who could face a large, sudden jump in their premium in 10 years or sooner if they don't take action, such as by voluntarily increasing premium payments or reducing the policy's death benefit.

Nicholas Vertullo, an 85-year-old former high-school teacher outside New York City, has three universal-life policies issued by a unit of American International Group Inc. One of them initially earned 9% on its savings account. The policies' accounts today fetch 4% to 4.5% interest.

"I was abstractly aware that interest rates could vary," Mr. Vertullo said. After the 2008 financial crisis, "the whole thing came home in a way that it was no longer an abstraction.... These life policies were quicksand."

For death benefits totaling about $475,000, Mr. Vertullo is paying about $30,000 a year, triple the original premiums.

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SUBMIT

The tumble in interest rates didn't affect just customers—it also dinged insurers' profits. As corporate-bond yields fell below 5% in recent years, insurers earned less from investing premiums, yet still had to pay guaranteed minimums of around 4% on universal-life savings accounts.

With future profits expected to be hurt by low rates, at least a half-dozen insurers have invoked policy provisions that they say allow them to raise the rates used to calculate the annual cost of customers' term insurance, according to ITM TwentyFirst, which provides policy-management services.

This means some customers see costs rising not simply because they are a year older, or because their savings account didn't grow as planned, but because their insurer has changed its price formula. As a result, even some customers who kept their policies well funded are being hit with unexpectedly higher costs.

One is Douglas Bradley, 83, a longtime health-insurance broker in California, whose premium roughly doubled because of a change made by insurer Transamerica. "I am absolutely stupefied at this," Mr. Bradley said.

Transamerica, a unit of Aegon NV, declined to comment on Mr. Bradley's situation but said its change was contractually permitted.

Such increases are "causing more life-insurance policies to expire even quicker than before" as customers who can't afford them drop their policies and hand insurers "windfall profits," said Henry Montag, a principal with The TOLI Center East in Melville, N.Y., which evaluates policies held in trusts.

Mrs. Sack, the 94-year-old retired hospital billing clerk, was warned by her insurance agent in 2000 that the universal-life policy she bought in 1983 was financially off track.

Mrs. Sack had borrowed a little over $4,000 from it and had skipped some payments. Also, while the policy's savings account initially earned over 10%, by 2000 this was down to 5.7%. She lowered the death benefit to $21,000 from $25,000 to repay the loan but still had to nearly double her premium, to $100 a month.

Bernice Sack lays out a folder of paperwork she has collected regarding her increasingly hard-to-afford universal-life policy. Right, Mrs. Sack with her family in 1983, the year she bought the policy. PHOTOS: MADELINE GRAY FOR THE WALL STREET JOURNAL(2)

The premium kept rising. She borrowed a few thousand dollars more from the policy, and the interest return continued to slide, to the 4% minimum.

Her experience is detailed in an inch-thick stack of documents, bills and correspondence, with scribbled names of Lincoln National representatives she and her daughters have spoken to in their efforts to figure out the situation.

Mrs. Sack complained last year to North Carolina's insurance department. It responded that "we understand your frustrations" but that the company appeared to be in compliance with policy provisions.

Even though Mrs. Sack has paid more for the insurance—approximately $39,000—than her heirs will ultimately receive, she doesn't dare stop paying and let it lapse.

"My prime concern is my burial," Mrs. Sack said. "My children are all so supportive, but I don't want them to pay for mine."

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SHOW CONVERSATION (505)