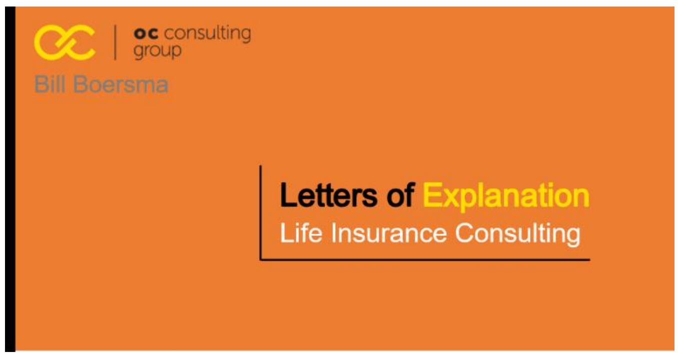
This letter is to a client explaining why the term blended whole life policy on his mother is failing:

Dear Mr. Client:

Unfortunately I still do not have what I requested from XYZ Life but I was able to do some work anyway. Also, what I requested may end up being sent directly to the policy owner, which is you as trustee, at the address of record.

You had asked about potential income tax consequences regarding this policy and I believe there would be none as it looks like the gross cash value is less than what I calculate the basis to be in the contract. I am waiting on a formal basis and gain calc from the company.



I want to take a minute to explain why what is happening to your policy is happening, in case you haven't already heard from someone else.

As you already know, the $1,000,000 whole life policy on your mother was originally issued as 50% whole life and 50% term insurance. This reduces the premium but also changes some aspects of the contract.
Hypothetically, the whole life portion of the policy was supposed to generate dividends which bought small pieces of paid up insurance (paid up additions or PUAs) which reduced the amount of term insurance correspondingly.

Ultimately the term portion was to be entirely replaced by the whole life and potentially grow to a death benefit greater than the original $1,000,000. However, dividends are largely driven by the interest rate markets and they have been coming down for 35 years so the dividends your policy was counting on never materialized. Because of this the term insurance wasn't replaced and this is causing your problems.

The term insurance was always priced to be increasing over time but that was theoretically not an issue because it was supposed to go away. But it didn't go away. In fact, in recent year paid up additions have been surrendered to pay for the increased term premiums. This has caused the term portion, which was shrinking due to the whole life portion growing to actually be growing as the whole life portion is shrinking.

The total premiums required to pay for the whole life and term portions have been higher than your original premium for a while but the policy was making up the shortfall through internal funding. Everything has finally come home to roost because the policy is out of money to properly fund itself. You may have been aware of this but many policy owners are not.

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I have run some quick internal rate of return calculations to determine the most attractive financial direction to go with the policy. As I think you understand, the options include:

- getting rid of the term and paying the base premium (death benefit will grow slowly over time)
- getting rid of the term and paying the spread between the base premium and the dividend (death benefit will stay level)
- keeping the term and paying the original $36,465 annual premium (death benefit will drop)
- keeping the term and paying the full required premium (death benefit will slowly grow)
- cashing out and doing something else with cash value
- sell the policy to a third party

I am hesitant for you to make decision based on these numbers because they are not exact given the fact I don't have from the carrier what I need. None-the-less, the highest rate of return would be to keep the term and pay the full required premium every year for both the whole life and term portion. The worst would be to terminate the term portion and pay the base premium on the whole life portion a year. Paying what you have been paying and having the death benefit slowly degrade comes in the middle.

The best decision is driven by mom's life expectancy but we know that is an unknown. That being said, the internal rate of return looks great for any of the scenarios for the first 4 or 5 years and bad for any of the scenarios in the last 7 or 8 years. Wouldn't you know it, the middle ground is mom's actuarial life expectancy.

As I mentioned to you earlier, I do not think you need to make an unnecessarily quick decision. Even though the premium is due this month, nothing should happen for a month or two if it is not paid. I would recommend you call customer service to determine precisely what the non-forfeiture option (the default option if you don't pay) is on your policy and precisely when it happens.

Please let me know what questions or concerns my comments drive and I will be happen to answer them. I will get you the detailed return numbers and analysis when the information shows up from the company.

Thank you,

Bill

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