Dear Policy Owner:

An explanation of what's happening

Though this is pretty simple, I've run into it repeatedly lately, and regardless of how often I have to explain it to policy owners, it's always the first time for whomever I'm talking to.

In this situation, the policy owner struggles to understand how his policy is out of cash value and why the premium is increasing. Furthermore, why did the insurance carrier send a projection showing the policy lapsing at age 80 despite a request for it to stay in force indefinitely?

oc consulting group
Bill Boersma

Letters of Explanation
Life Insurance Consulting

Hi Rick:

Thank you for sending along the information you have. I see what's happening. Since the policy was issued in 2004, the crediting rate has been reduced as the interest rate market fell. Consequently, the required premium has to be increased for the policy to last.

This is no different than, for example, doing your retirement planning assuming 9% and then later reducing your expectation to a more conservative 7%. You'd have to increase your planned contributions to hit your goal or lower your expectations. The 9% was never guaranteed; simply an assumption.

It's the same with many life insurance policies. The premiums were never guaranteed, as many people thought. Too many people have an old-fashioned understanding of life insurance and don't understand how this works. Besides that, the policy could have been built in numerous different ways. Without seeing the original sales ledger, I have no idea if it was built aggressively or conservatively. There's no hitting a button to see what the premium is when looking at life insurance. There are multiple choices an agent has to make when in the carrier software, and each option is a bit of give and take. I could build two policies that look the same to you on the surface but act very differently and have a very different chance of success, even with the same product from the same insurance carrier. Most of these decisions you'd never be aware of. Either way, your policy needs more premium now to go the distance.

You can see that multiple projections are included based on different assumptions. I would pay attention to the third one, which assumes current crediting and expenses. This shows a 50% increase in premiums from what you currently pay, yet the policy is projects to lapse at age 80. For almost everyone, this is insufficient. Unfortunately, though I requested the required premium for the policy to last beyond age 100, there's a reason they did not show a higher premium. There are insurance and tax laws and guidelines that limit the amount of premium that can be put into an insurance policy and have it still be qualified as life insurance with the associated tax benefits. These laws were enacted during the high interest rates of the 80s to keep life insurance from being abused as a tax shelter.

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Unfortunately, though we are in a dramatically different interest rate environment, those laws are still in effect. The ledger they sent shows the highest annual premium they can illustrate while still being within the guidelines. The law does allow a policyholder to pay whatever it takes to keep a policy in force, but the insurance company cannot illustrate it. When the policy runs out of cash value, the company can calculate what it takes to keep it in force for another year, though it would be acting like annually increasing term insurance and would be prohibitively expensive.

Does this make sense? I recommend you give some thought to how important this insurance is. If you come to the conclusion you want to continue having permanent coverage in place, the first thing we should do is benchmark this current policy to market options. We can also evaluate term options for pure insurance coverage. If insurability is not an issue, it's not uncommon for current market options to look more attractive than an existing policy in this state. Whether that is the case or not, that's the first step. I'll start running numbers and we can discuss soon. Please let me know what questions you have for me now. I look forward to it.

Thanks,
Bill

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