Timing of Premium Payments

In my May 12th, 2015 post, Why Paying Attention is Important, I referenced a hypothetical issue which has just come across my desk in real life. It has to do with a Guaranteed Universal Life (GUL) policy and the timing of premiums.

Much has been made of the sensitivity of GUL contracts to the timing of premiums, and for good reason. Many policies do not have the grace periods of more traditional policies. A premium which comes in late, may slightly affect the internal formulas which determine the guarantees and, consequently, the policy may not last as long as expected.

One of the issues I wrote about in 2015 is when GUL premiums are paid too early. This is a real issue because given the sensitivity to late premiums, it is often beat in to GUL contract owners to pay the premiums on time, which generally means early.

However, no good deed goes unpunished. I order in-force ledgers every single year for every policy I am involved with, even single pay GUL contracts. Believe me, I have found more than a couple home office mistakes, let alone policy owner oversights and agent errors. The case I am referencing is a $3,000,000 second-to-die SGUL contract put in force on a guaranteed 20 pay of $18,978.36 a year.

Every year the ledger has shown what we expected and it goes in the file until next year. The policy date is February 1, 2007. This year the in-force ledger shows the death benefit lapsing at age 99 of the younger insured. That may still be decent and about four decades from now but it is not what was put in force, not what the clients are paying for and, given the joint life expectancy of two healthy individuals, the chances of one of them outliving the policy is real.

My first thought was that the premium was paid late last year so I referenced the annual statement and saw that it was paid and applied in January as would be expected. So, I have a ledger from the carrier from one year ago which shows it guaranteed for life and one this year that shows something different and the premium was paid on time. What gives?

The premium was paid too early.

Why is that an issue now and not in any of the other years the premium was paid in January? The internal mechanics and charges of the policy. Many contracts have a fixed premium charge for the first 10 years and another for years 11 and on. Let's say the annual premium expense for years 1 through 10 is 10% and for years 11 and on it is 5%. If you pay the premium early in years 1 through 10 the charge is 10 percent regardless. However, the guarantee formula for this contract assumes that the year 11 premium is being charged at 5% and if it is paid in January, which is technically still in the first 10 years, a 10% charge is being taken out of the premium which is twice the anticipated charge. It's like cutting a check for this year for $950 less than what is due (5% of $18,978). That difference is enough to violate the guarantee formula and cause the policy to lapse early. Seriously.

This was my assumption but I kept it quiet when approaching the carrier asking for an explanation. They confirmed it for me exactly. Furthermore, without even pushing, they reapplied the premiums as of

2/1/17 and re-ran the ledger showing a guarantee to 120. Good for them. Not every carrier may be this cooperative. I've been in fights where I had recorded proof a carrier screwed up and they wouldn't come clean. Others have retroactively changed the formulas or instituted grace periods which gave a month leeway on either end. Some will change it if you catch it and call them on it and others will let it slide if no one says anything. The problem is, if a given carrier hasn't made accommodations for this, it may be quite impossible to pay "on time" unless the check is delivered and applied on a single given day, which is effectively impossible to ensure, or the premium will either be early or late and there may be problems.

As an aside, this may be a reason to not put a policy in force for $18,978.36 rather than round up to $19,000 or even $19,500. Calculating something to the penny gives a contract no buffer and makes it more susceptible to the issues we are discussing. Is that premium difference worth risking the entire death benefit of a policy? Do you think it might not be significantly more difficult to go back 10 or 20 years and prove this to a carrier and get them to make amends? We're not even talking about "wasting money" here. I've done this before where, before the 20th and final premium was due, we had the carrier calculate the exact premium to maintain the guarantee for life and then paid that exact amount which "got us back" our overpayments with interest.

The bottom line is this is one more call for vigilance at a level which is unrealized to the consumer market, unpracticed by a vast majority of agents, unknown to even most professional trustees and clearly unreasonable except for the fact it is mandatory given the realities of the world.