



Variable Life Insurance: Reviewing Policy Performance is Critical

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For most consumers, deciding to purchase life insurance is not at the top of your “to do” list. Setting aside time to visit with an agent and understand the different types of available life insurance can easily get pushed to the back burner. For the millions that have chosen variable life insurance for personal, business or estate planning purposes, understanding the investment element of the insurance and how it can affect the long term sustainability of the policy is critical.

Variable universal life insurance allows a policy owner to invest the cash value within the policy among various sub-accounts. When these sub-accounts are chosen, a policy owner assumes the same risks associated with similar investments. You can choose sub-accounts that invest in stocks, bonds or a combination of each. The sub-accounts available are similar to mutual funds but are specific to these types of policies. As a result, there is the potential for higher returns and an increase in the policy cash value (...or not).

However, the volatility and the negative returns of 2008 highlight the fact that negative returns directly impact the cash value of your policy. As is the case with traditional investments, staying invested allows the policy owner the opportunity for recovery. This is also true with variable life insurance but with a significant difference. The consequence of ongoing underperformance of the sub-account investments compared to the original illustration may cause your policy to terminate. If your policy has lapsed, the beneficiaries may receive no benefits whatsoever.

When a variable life insurance policy is issued it is issued with very specific assumptions. Assumptions such as the amount of premium to be paid, the hypothetical annual rate of return (based on sub-account performance described above), and certain policy/sub-account charges and fees. The rate of return

assumption is particularly important as a higher assumed rate of return can lower the amount of annual premium needed to support the policy.

When performance differs from these assumptions, long term policy performance can change for the positive or negative. For example, a policy owner may decide to increase the amount of premium they want to pay with the goal of increasing the cash value.

A real life example will better illustrate this point. In 1997, Mr. and Mrs. Goodplan worked with their CPA and attorney to analyze their estate planning needs and desires. After reviewing their situation, they determined they would like to hedge their estate tax risk and provide for some additional charitable planning. They decided that survivorship life insurance can help them with this overall goal and established an irrevocable life insurance trust to own the policy. Survivorship life insurance insures both husband and wife with the death benefit proceeds paying out at the death of the second insured.

Mr. and Mrs. Goodplan (along with their trustee) reviewed the different types of coverage available and the trustee purchased a variable universal life insurance policy insuring both of them. At the time, the stock market was experiencing very favorable returns and they were comfortable with the investment element of the insurance. The annual rate of return assumption that was used when the policy was implemented was 10% and the premiums were allocated 100% to sub-accounts that invested in the stock market. The policy projected to remain in-force for their lifetime (age 95+).

They continued to gift premiums to the trust over the next ten years which were invested in the same sub-account investments. At the request of their advisors, Mr. and Mrs. Goodplan had their estate plan reviewed which included a review of their life insurance policy. The conclusion of the policy review was that if the same premium was paid and all other factors remained the same (hypothetical rate of return, policy costs and fees, etc.) as initially illustrated, the policy projected to terminate when they were in their early 80's. Much of the planning for their beneficiaries and charities dramatically changed.

One of the primary factors causing this was that investment performance did not grow the cash value as originally projected and the policy was running short on funding. Without investment outperformance to get it back on track, the policy will require additional funding over what they had been accustomed to gifting.

Variable life insurance can be a suitable type of coverage for the right circumstances. Regardless of the circumstances, policy performance needs to be reviewed on a regular basis to ensure planning success.

If you would like more information on this topic, please contact Brian Cose at 800-791-8994 or bcose@hkfs.com.

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