

Whole Life Versus Universal Life
The Other Side of the Story
Comparing Whole Life
to Universal Life with a No-lapse
Secondary Guaranteed Death Benefit

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Whole Life Versus Universal Life With Secondary Guarantees

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Executive Summary

Since its relatively recent introduction, Universal Life with a no-lapse secondary guaranteed life benefit has been sold to many insurance buyers as a low-cost alternative to Whole Life. All too frequently, a reduced premium and a guaranteed death benefit are the *only* policy features that consumers have considered in deciding which type of insurance to purchase.

However, a thorough comparison of all the features, benefits and provisions of Whole Life with no-lapse Universal Life demonstrates that the new Universal Life with secondary guarantees can prove much less valuable and attractive than their buyers have been led to expect.

This paper is designed to shed new light on the two types of life insurance, providing in-depth analysis of how no-lapse Universal Life policies with a secondary guaranteed death benefit actually stack up to the performance of traditional Whole Life insurance coverage when all of their features are realistically, and rigorously, compared.

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Moody's

Fitch

Insurance Forum

Whole Life Versus Universal Life With Secondary Guarantees

I. Introduction

The purpose of this paper is to provide a comparative analysis of whole life insurance policies and universal life policies with a secondary guaranteed death benefit. Whole life insurance policies have been available for over 150 years and consequently the design of this type of policy is well known and the standard provisions of the policy are well established and uniform across all companies.

Universal life policies are relatively new having been first introduced during the early 1980's. In recent years a new variation of universal life has been introduced with what is called a secondary guaranteed death benefit. This new variation contains a dramatically different form of guaranteed death benefit that has been layered onto universal life policies. This benefit has been added in order to address some of the perceived weaknesses of the basic universal life policy.

This analysis will begin with a short review of the basic whole life and universal life policy. Then the secondary guaranteed benefit that is added to universal life is examined. Two key features that distinguish the different types of policies are then evaluated. Then an analysis will be provided that compares the cost and benefits of whole life and universal life with a secondary guaranteed death benefit. Finally the long-term financial implications for insurance companies that issue universal life with secondary guaranteed death benefit are addressed.

II. Whole Life Insurance

Whole Life is an insurance policy that provides lifetime insurance protection with **significant guarantees** and **tax benefits** for the policyowner. When actuaries design a whole life policy, they begin by determining what rates are going to be guaranteed. The three guaranteed rates are:

- ❑ The guaranteed **interest** rate – this rate, for current Guardian policies, is 4.0% for the entire life of the policy.
- ❑ The guaranteed **mortality** rate – this guarantee for current Guardian policies comes from the 1980 CSO table, a table of guaranteed mortality rates that is required by insurance regulations.
- ❑ The guaranteed **expense** factor – an allocation for expense that is covered in guaranteed values.

Once the guaranteed rates have been set, they are used to determine policy premiums and values. Guaranteed rates and values are based upon conservative assumptions. Whole life insurance provides the policyowner three guarantees:

- ❑ A guaranteed **level premium** – The annual premium is contractually guaranteed to never change.
- ❑ A guaranteed **death benefit** – The level death benefit is contractually guaranteed never to go down.
- ❑ A guaranteed **cash value** – The contractually guaranteed cash value grows each year until it is equal to the face amount of the policy at a specified age, usually age 100.

Whole Life offers the ability to provide value **in excess of its guarantees** through dividends. Dividends are paid to the policyholders if declared by the Board of Directors. When dividends are declared, they have three components:

- ❑ The insurance company's investment **rate of return is in excess of the guaranteed return** promised in the policy,
- ❑ Mortality **experience which is better than that which is guaranteed** in the policy, and
- ❑ Expenses of policy administration which are **less than the cost guaranteed** in the policy.

III. Universal Life Insurance

Traditional Universal Life

Universal life is a flexible-premium, adjustable-benefit life policy with an account value that accumulates on a tax-deferred basis. This type of policy is designed to give the policyholder flexibility to change the premium and death benefit of the policy while retaining the tax benefits of life insurance.

Universal life has three sets of guaranteed rates but, unlike whole life, the rates are not put into an actuarial formula to determine a guaranteed premium, guaranteed cash value and guaranteed death benefit. The guaranteed rates are:

- ❑ The guaranteed **interest** rate – this rate varies by insurance company and is usually between 2.5% and 4.0% on currently sold policies
- ❑ The guaranteed **mortality** rate – this guarantee comes from the 1980 CSO table, a table of guaranteed mortality rates that are required by insurance regulations on currently sold policies
- ❑ Guaranteed **expense** charges – an allocation for expense

Each month a calculation is made to determine the current policy account value:

- ❑ The **interest** rate credited on the policy account value will be the greater of the current rate or the guaranteed rate.
- ❑ The **mortality cost of insurance charge** will be the lesser of the current cost of insurance charge or the guaranteed cost of insurance charge.
- ❑ The **policy expense charges** will be the lower of the current expense charge or the guaranteed expense charge.

The account value increases with premium payments and credited interest and decreases with deductions for mortality cost of insurance charges and policy expense charges. Each month a calculation is performed in which the greater of the current interest rate or the guaranteed interest rate is credited to the outstanding account balance after the mortality charge and expense charges have been deducted. The insurance company can change the mortality and expense charges as prevailing conditions change but they are subject to a maximum that is specified in the policy.

Universal life has been offered as an insurance option since the early 1980's. The major concern for the policyholder is that the policy will lapse if the cash surrender value falls to zero. This may happen if one or more of the following conditions prevail:

- ❑ The policy was inadequately funded with premiums;
- ❑ The actual interest credited over the life of the policy was inadequate; or
- ❑ The mortality and expense charges were increased, thus dissipating the policy account value.

Whole Life Versus Universal Life With Secondary Guarantees

Universal Life With a Secondary Guaranteed Death Benefit

❑ **The Guaranteed Death Benefit:**

- Many purchasers of universal life policies during the high interest rate era of the 1980's and 1990's were disillusioned by the poor performance of their policies as interest rates declined year-after-year.
- In an effort to remove the negative stigma of universal life policies that had not lived up to expectations, the insurance industry started to offer a guaranteed death benefit if a stipulated minimum premium was paid every year.
- At first, the additional death benefit guarantee was offered for a limited period of 5 to 10 years. This quickly expanded to 20, then 30 and 40 years, and finally for the life of the policy.
- This guaranteed death benefit is provided even if the cash value of the policy falls to zero. This additional guaranteed death benefit is called a Secondary Guaranteed Death Benefit. The benefit is secondary because it is in addition to the death benefit guarantee that is provided by the guaranteed interest, mortality and expense charges of the policy.

❑ **The Guaranteed Premium**

- The secondary guaranteed death benefit of universal life is provided when the stipulated premium is paid on a timely basis.
- The most common design is a low level premium that must be paid in all years until the insured is age 100. The flexible premium capability of universal life also permits the use of limited payment premium schedules.
- A single premium design is frequently used by agents who are replacing the coverage of other types of insurance policies.
- Often the cash value of an existing policy is used as a single premium to purchase secondary guaranteed UL with the single premium being calculated so that it guarantees the death benefit of the new policy.

❑ **Policy Cash Values**

- The key feature of universal life with a secondary guaranteed death benefit is continuation of the death benefit coverage even when the cash value of the policy declines to zero due to poor investment experience and/or increased mortality or expense charges.

Conditions That Must Be Complied With to Maintain the Secondary Guaranteed Death Benefit

- ❑ Any one of a number of changes or events during the life of a policy can result in either the loss of no-lapse guaranteed coverage provided by a secondary guaranteed death benefit or in a shortening of the guarantee period. These changes and events could include:
 - A late premium,
 - A skipped premium,
 - A policy loan,
 - A withdrawal,
 - A non-scheduled change in the face amount,
 - A change in the death benefit option, or
 - The addition of a rider or other benefit after the policy has been issued.

Whole Life Versus Universal Life With Secondary Guarantees

- ❑ The original design objective of universal life was to provide flexibility and options to amend an existing policy in future years.
- ❑ Due to the numerous conditions that must be complied with in order to keep the no-lapse secondary guaranteed death benefit in force the policyowner has limited flexibility and options to modify coverage in future years as the requirements and condition of his or her personal life change.
- ❑ Universal life with lifetime no-lapse secondary guaranteed death benefits first became popular in 2000 and 2001. This product is still relatively new. Consequently uniform policy provisions have not been developed and codified through litigation, case law decisions and insurance regulations.
- ❑ If the secondary guaranteed death benefit is forfeited, then the account values of the UL policy would have to support the death benefit of the policy. As shown in a subsequent illustration, the policy values of no-lapse UL policies are often very unattractive even when shown at current interest rates, mortality charges and expense charges. The low level of cash values coupled with the low planned premium of the policy may result in the account value falling to zero and the policy lapsing.

IV. Comparison of Two Key Policy Features

Accessibility of Policy Values

Cash value life insurance policies offer the ability of the insured to access cash values while the policy is in force. Depending upon the type of policy, cash value may be withdrawn, surrendered or borrowed from a policy. (Loans from a policy will result in an interest charge.)

- ❑ **Whole Life**
 - The cash value of the life policy may be borrowed against by the policyowner.
 - Participating whole life policies may have paid-up-additional insurance (PUA) that has been purchased by dividends. PUAs provide additional guaranteed cash value and guaranteed death benefit.
 - PUAs may be surrendered or borrowed against in order to access their cash value.
 - Neither the surrender of dividends nor loans against a whole life policy will change the guaranteed death benefit or the cash value features of a whole life policy.
- ❑ **Traditional Universal Life**
 - Universal life cash values can either be withdrawn from the policy or borrowed using the loan feature of the policy.
 - Traditional universal life may lapse if there is inadequate policy cash value and premium paid into the policy to pay the mortality and expense charges.
- ❑ **Universal Life With Secondary Guarantees**
 - The cash value of universal life with secondary guarantees can also be withdrawn or borrowed from the policy. However, these types of contracts often have provisions, that stipulate that the guaranteed death benefit of the policy may be forfeited if either a withdrawal of cash value or a loan is made against the policy.

Whole Life Versus Universal Life With Secondary Guarantees

- Generally, with most policies, a withdrawal of cash value from a universal life policy with secondary guarantee will void the secondary guaranteed death benefit.
- Loans against a UL policy may void the no-lapse secondary guaranteed death benefit.
- Some companies offer the ability to take loans against a policy without voiding the secondary guarantee. When this provision is offered, the cost of the loan is measured by the spread between the loan interest charged and the interest credited to the portion of the cash value that is loaned and is usually high, typically 200 basis points.

Payment of Premiums

□ Whole Life

- Whole life is issued with a guaranteed level premium based upon the insured's age at issue.
- The insurance coverage will stay in force as long as the insured lives and the premiums are paid.
- Dividends may be used to reduce the premium that is required on the policy.

□ Traditional Universal Life

- In order to keep a traditional universal life or variable universal life in force, premiums must be paid to pay for the mortality cost of insurance charges and the policy administration charges levied against the contract.
- If there is no policy cash value, these charges will become larger and larger as the insured becomes older and older.
- If there is no policy account value and inadequate premium is paid, the policy will lapse and the insured will lose the insurance coverage.

□ Universal Life With Secondary Guarantees

- The specified premium on a universal life with a secondary guaranteed death benefit policy must be paid in order to keep the secondary guaranteed death benefit in force.
- If the premium is skipped or missed, the secondary guaranteed death benefit may be lost or the length of the guaranteed death benefit may be reduced from a lifetime guarantee to a shorter period of time.
- ***Catch-up Provisions:***
 - In order to address the loss to the secondary guaranteed death benefit, many companies have added a catch-up provision that allows the policyowner to reinstate the secondary guaranteed death benefit if premiums have been skipped or missed.
 - There are two basic variations of catch up provisions, limited and unlimited lifetime.
 - ***Limited Catch-up provision:***
 - A limited catch-up provision provides a limited period of time, usually two to five years, during which the policyowner may pay premiums that have been skipped and reinstate the secondary guaranteed death benefit.
 - ***Unlimited Lifetime Catch-up provision:***
 - The unlimited catch-up provision allows the policyowner to pay missed premiums at anytime while the policy is in force and reinstate the secondary guaranteed death benefit.
 - The unlimited catch-up provision may or may not have an interest charge required to be paid along with the payment of missed premiums.

V. A Comparison of Universal Life with a No-lapse Secondary Guaranteed Death Benefit and A Whole Life Policy

When universal life with a no-lapse secondary guaranteed premium is offered by an agent as the solution to his client's insurance needs, the rationale for the choice of insurance is guaranteed death benefit and price. Since the early 1980's insurance buyers have been offered insurance solutions that have ultimately failed to deliver the benefits that agents and insurance companies had offered to the consumer.

- ❑ ***UL During the 1980's:*** During the 1980's, universal life policies offered the prospect of higher rates of return than whole life insurance policies because the underlying investments were placed in short-term fixed income instruments. At that time the short-term investments of universal life product portfolios had a much higher rate of return than the long-term general account portfolios that backed whole life policies.
- ❑ ***The Decline of Interest Rates and of UL:*** As interest rates declined through the 1980's and into the 1990's, policyowners saw the high interest crediting rates on universal life policies decline year-after-year to very low levels. Dissatisfied with the performance of traditional universal life policies, their attention was diverted to universal variable life.
- ❑ ***VUL Offered In the Place of UL:*** Universal variable life (VUL) offered the prospect of higher rates of return through cash value subaccounts that were invested in stock market based equity accounts. The long bull market of the 1990's lulled insurance purchasers into thinking that the risks of equity markets were lower than they really were.
- ❑ ***The New Millennium – Volatility Is Alive and Well:*** The market decline of the first two and one half years of the new millennium convinced insurance buyers that equity market volatility was alive and well so they were well positioned to buy into the next new and "best" insurance solution that would provide a combination of low premium and guarantees. The insurance industry stepped into the void and started providing universal life with a no-lapse secondary guaranteed death benefit.
- ❑ ***No-Lapse Offers Low Premium and Death Benefit Guarantees:*** No-lapse universal life offered a guaranteed death benefit with a substantially lower premium than traditional whole life, which was the only other type of life policy that offered guaranteed lifetime death benefit protection with a guaranteed level premium.
- ❑ ***No-Lapse UL Seem To Good To Be True:*** The premium on no-lapse universal life is 35% to 45% of a whole life premium. At first glance the savings of 65% to 55% in premium seems to be too good of a "bargain" to pass up. Consequently, the sale of no-lapse universal life has increased dramatically.
- ❑ ***No-Lapse UL Is Not As Great As It First Appears:*** The initial offer of a reduced premium and a guaranteed death benefit is often the only inducement that consumers will take into consideration when making a decision to purchase insurance. A thoughtful analysis of all the features, benefits and provisions of each alternative often would reveal that the value of the new no-lapse universal life policies as a total package is not as great as it first appears.
- ❑ ***Upside Potential Given Up with No-Lapse UL:*** In addition to limited accessibility to policy cash values the purchaser gives up most of the upside potential for growth of policy values due to the expense charges that are built into secondary guaranteed UL policies to pay for the guaranteed death benefit.

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The Analytical Methodology – Virtual Cash Values versus Fungible Cash Values

- ❑ ***UL “Virtual” Cash Values:*** Due to the loss of the secondary guaranteed death benefit when there are withdrawals or loans from a no-lapse universal life policy, the cash values are not realistically available to the policyowner and could rightly be called “*virtual*” cash values. That is, they appear on the statements sent out to the policyowner and are available if a policy is surrendered but they cannot be accessed in the event of financial opportunity or distress without the loss of policy death benefit guarantees.
- ❑ ***No-Lapse UL similar to Term to Age 100:*** The required premium payment characteristic of no-lapse universal life when combined with inaccessibility of cash values makes it very similar to a level term policy to age 100.
- ❑ ***Whole Life “Fungible” Cash Values:*** In contrast to no-lapse universal life, whole life cash values, are fully accessible by the insured during his or her lifetime while the policy is in force. Therefore, it can be said that the whole life cash values are “fungible”, that is accessible, usable and convertible as a medium of exchange for a myriad of goods and services.
- ❑ ***Fungibility Can be Measured:*** Fungibility, as offered by whole life insurance, can be measured by the difference between the additional premium that must be paid for a whole life policy compared to the premium that must be paid for a no-lapse universal life policy with secondary guaranteed death benefit and “virtual” cash values.
- ❑ ***The Value of Fungibility*** The value of the fungibility offered by a whole life policy can be gauged by an analysis that calculates the rate of return that must be earned on the additional premium paid into a whole life policy to obtain the fungible cash and additional death benefit provided by the whole life policy.
- ❑ ***Guaranteed Cash Fungibility:*** The rate of return analysis on the fungible cash value can be done on the guaranteed cash value of the whole life policy and the total cash value of the policy.
- ❑ ***Total Cash Fungibility:*** The total cash value includes the guaranteed cash value and the cash value that comes from dividends paid on the policy. The payment of dividends is not guaranteed in any year; *however, The Guardian Life Insurance Company of America has paid a dividend every single year since 1868.* An illustration of dividends in future years is based upon the current year’s dividend scale and is not guaranteed. The illustration of dividends is based upon non-guaranteed elements, which remains unchanged for all years shown. This is not likely to occur and the actual results may be more or less favorable than those shown.
- ❑ ***Paid-Up-Additions Analysis:*** The whole life policy provides additional death benefit if dividends are used to purchase paid-up-additional life insurance. An analysis that compares no-lapse universal life to whole life would be incomplete if it did not include a rate of return analysis on the additional death benefit provided by paid-up-additions.
- ❑ ***Competitive UL Used in the Analysis:*** The universal life policy illustration is typical of a highly competitive no-lapse contract. There are five parts to the universal life policy: the premium, the guaranteed cash value, the guaranteed death benefit, current cash value and the current death benefit.
- ❑ ***UL Current Assumptions Are Subject to Change:*** The interest rates shown are effective annual rates. They are subject to change but will not go below the minimum set forth in the policy. Mortality cost of insurance charges and policy expense charges are subject to change, but will never exceed the guaranteed maximum charges set forth in the policy.
- ❑ ***UL Guaranteed Cash Values:*** The guaranteed cash value column in the universal life illustration shows the cash value of the policy if the interest rate credited was reduced to the guaranteed level and the mortality and expense charges were raised to the maximum permitted in the policy.

Whole Life Versus Universal Life With Secondary Guarantees

Comparison Commentary

❑ The First Illustration – A Comparison of Policy Values

There are five pages to the comparative illustration. The first two illustration pages show a side-by-side comparison of a Guardian whole life policy with the 2004 dividend scale and a representative illustration of a no-lapse universal life policy with a secondary guaranteed death benefit. The side-by-side comparison yields the following differences between the two policies:

- **The Difference in Premium:** The difference in premium between the whole life and the universal life is \$5,250 per year.
- **Initial Death Benefit:** Both policies start out with an initial death benefit of \$500,000.
- **Whole Life Values:** The whole life policy has a substantial and growing cash value and death benefit.
- **Universal Life Values:** The universal life policy has a very low cash value and a level death benefit.
- **Zero UL Cash Using Current Assumptions:** The universal life cash value falls to zero by age 81 under current interest and expense assumptions.
- **Consequence of No UL Cash by Age 81:** By age 81 if the secondary guaranteed death benefit had been forfeited due to non-compliance with the policy terms, then at current rates and current charges there would be no cash value to pay mortality and expense charges. Consequently, the planned premium may be inadequate to pay policy charges and the contract could lapse.
- **Dividends Result in Growth of Whole Life Values:** As the insured gets older, the dividend values of the whole life policy at the current scale keep on getting larger and larger, providing greater cash values, and death benefit. The increasing values provide a better financial buffer to shelter the economic well being of the insured.
- **PUA Values Guaranteed Once Declared and Paid:** The cash value and death benefit of the paid-up-additions are guaranteed by Guardian once the dividends have been declared and paid into the policy.

❑ The Second Illustration – A Rate of Return Analysis

The second illustration provides a rate of return analysis of the whole life policy fungible guaranteed cash values, fungible total cash values and the additional death benefit provided by the paid-up-additional insurance that is purchased with dividends. The following observations should be noted from the rate-of-return analysis of the fungible cash and excess death benefit:

- **Year Ten Guaranteed Cash Value Analysis:** The \$5,250 difference in premium would have to be invested at a compound annual rate-of-return of 7.15% in order to equal the guaranteed cash value of \$78,275 in the whole life policy in the 10th year.
- **Year Ten Total Cash Value Analysis:** The \$5,250 difference in premium would have to be invested at a compound annual rate-of-return of 9.86% in order to equal the total cash value of \$91,327 in the whole life policy in the 10th year.
- **Life Expectancy Excess Death Benefit Analysis:** By life expectancy, which is approximately age 84, the \$5,250 would have to be invested at a compound annual rate of return of 6.09% in order to equal the excess death benefit of \$880,927 provided by the whole life policy.
- **Whole Life Cash Values are Fungible:** The cash value in the whole life policy is fungible at all times, that is, fully accessible by the insured during his lifetime either through the surrender of paid-up-additions and/or through a policy loan. (It should be noted that a policy loan on any type of policy will result in a reduction of the death benefit equal to the loan.)

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- ***Accessing Whole Life Cash Values Does Not Effect Guarantees:*** Accessing whole life insurance cash values will not change the guaranteed nature of the whole life premium, guaranteed cash value or guaranteed death benefit.
- ***Guardian's Dividend Scale:*** The illustrated dividend values are based upon Guardian's 2004 dividend scale which can go up or down. Currently the interest rate component of the dividend scale is 6.60%. Over the past thirty years the dividend interest rate has been as high as 13.25% (in 1985 and 1986) and as low as 5.15% (in 1975). The average dividend interest rate over the past 30 years has been 8.84%.
- ***Guardian's Commitment to Mutuality:*** No one knows what will happen to interest rates and dividends in the future but Guardian is committed to remaining a mutual life insurance company and providing superior long-term value to its policyholders.

□ **The Graph Page**

The graph page provides a line graph of the rate-of-return data. This graph illustrates the rate-of-return advantage that Guardian whole life provides to the policyholder in the form of guaranteed cash value, total cash value and excess death benefit provided by paid-up-additions.

The Rationale for No-lapse Universal Life

- ***Low Premiums and Cash Values Are Irrelevant:*** As is seen in the representative illustration, universal life with a no-lapse secondary guaranteed death benefit has an attraction for the insurance buyer because it has a low premium for the same guaranteed death benefit as whole life. On the other hand, an examination of the policy provisions reveals that what little cash value is held in the policy is only accessible at the cost of losing the guaranteed death benefit, the very purpose for purchasing the policy. The lack of access to policy cash values is often offered as an irrelevant side effect to no-lapse universal life policies. Insurance agents and companies have been telling the consumer the cash value is not important. Is this really true?
- ***Cash Values Are Relevant In An Uncertain and Volatile World:*** Prudent planning for long term financial well-being that has scanned the economic history of the past century and that is in touch with the realities of the uncertain and volatile world that we live in would have to respond with a resounding, no! Accessible cash values are important for the simple fact that we do not know what a day may bring forth. Tomorrow may bring the economic opportunity of a lifetime for the insured or it may bring the grievous financial disaster of a lifetime. In both instances the presence of readily available cash values can be the means for the making of a fortune or the preserving of a fortune.
- ***Trust Owned Life Insurance:*** Often in estate planning, life insurance cash values are said to be irrelevant when life insurance is owned by a irrevocable trust because the insured and grantor of the trust does not have access to trust property that is usually held in trust for children and grandchildren. However, children and grandchildren are subject to the same uncertainty and volatility, opportunities and trouble as the insured and grantor of the trust. Irrevocable trusts can be drafted to give the trustee the power to access life insurance policy values for the benefit of the trust beneficiaries in the event of overwhelming opportunities or financial disaster.
- ***The Uncertain State of the Federal Estate Tax:*** At some point in the future it may be determined that life insurance is no longer required. This is especially true in light of the uncertain state of the Federal Estate Tax. If life insurance is purchased solely to provide liquidity to pay estate taxes and the tax is ultimately repealed then the insurance may not be needed and may be cash surrendered. If estate liquidity had been provided by a no-lapse universal life policy with its minimal cash values the insured, and his heirs would suffer a large loss. This loss would not occur if the estate liquidity funding had been provided through whole life insurance.

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A Comparison of Universal Life With A Secondary Guaranteed Death Benefit and Whole Life Insurance

Year		Age		Whole Life Insurance				Universal Life					
				Guardian - Whole Life 100 - Age: 45 - Rate Class: Best Class				A Representative UL Policy - No Lapse Secondary Guaranteed Death Benefit UL - Age: 45 - Rate Class: Best Class					
		Annual Premium	Base Policy Guaranteed Cash Value	Cash Value of Paid Up Additions	Total Cash Value	Base Policy Guaranteed Death Benefit	Paid Up Additions Death Benefit	Total Death Benefit	Annual Premium	Guaranteed Cash Value	Current Cash Value	Guaranteed Death Benefit	Current Death Benefit
1	45	9,148	0	0	0	500,000	0	500,000	3,898	0	0	500,000	500,000
2	46	9,148	0	100	100	500,000	100	500,100	3,898	0	0	500,000	500,000
3	47	9,148	8,465	236	8,701	500,000	404	500,404	3,898	0	0	500,000	500,000
4	48	9,148	17,705	716	18,421	500,000	1,093	501,093	3,898	0	0	500,000	500,000
5	49	9,148	27,135	1,566	28,701	500,000	2,652	502,652	3,898	70	1,718	500,000	500,000
6	50	9,148	37,020	2,828	39,848	500,000	5,086	505,086	3,898	0	4,527	500,000	500,000
7	51	9,148	47,090	4,554	51,644	500,000	8,431	508,431	3,898	0	7,325	500,000	500,000
8	52	9,148	57,335	6,801	64,136	500,000	12,732	512,732	3,898	0	10,163	500,000	500,000
9	53	9,148	67,740	9,612	77,352	500,000	18,022	518,022	3,898	0	12,935	500,000	500,000
10	54	9,148	78,275	13,052	91,327	500,000	24,332	524,332	3,898	0	15,645	500,000	500,000
11	55	9,148	88,950	17,162	106,112	500,000	31,691	531,691	3,898	0	18,372	500,000	500,000
12	56	9,148	99,750	22,004	121,754	500,000	40,119	540,119	3,898	0	21,045	500,000	500,000
13	57	9,148	110,690	27,601	138,291	500,000	49,614	549,614	3,898	0	23,707	500,000	500,000
14	58	9,148	121,775	34,008	155,783	500,000	60,160	560,160	3,898	0	26,359	500,000	500,000
15	59	9,148	133,000	41,309	174,309	500,000	71,807	571,807	3,898	0	29,064	500,000	500,000
16	60	9,148	144,360	49,531	193,891	500,000	84,565	584,565	3,898	0	31,800	500,000	500,000
17	61	9,148	155,825	58,779	214,604	500,000	98,479	598,479	3,898	0	33,906	500,000	500,000
18	62	9,148	167,385	69,139	236,524	500,000	113,632	613,632	3,898	0	35,967	500,000	500,000
19	63	9,148	178,995	80,738	259,733	500,000	130,132	630,132	3,898	0	38,036	500,000	500,000
20	64	9,148	190,640	93,640	284,280	500,000	148,048	648,048	3,898	0	40,055	500,000	500,000
21	65	9,148	201,450	107,880	309,330	500,000	167,373	667,373	3,898	0	41,964	500,000	500,000
22	66	9,148	212,235	123,571	335,806	500,000	188,149	688,149	3,898	0	43,650	500,000	500,000
23	67	9,148	222,990	140,797	363,787	500,000	210,440	710,440	3,898	0	44,995	500,000	500,000
24	68	9,148	233,730	159,520	393,250	500,000	234,162	734,162	3,898	0	45,967	500,000	500,000
25	69	9,148	244,445	179,897	424,342	500,000	259,363	759,363	3,898	0	46,631	500,000	500,000
26	70	9,148	255,110	201,964	457,074	500,000	286,085	786,085	3,898	0	46,942	500,000	500,000
27	71	9,148	265,665	225,920	491,585	500,000	314,486	814,486	3,898	0	46,971	500,000	500,000
28	72	9,148	276,055	251,833	527,888	500,000	344,678	844,678	3,898	0	46,103	500,000	500,000
29	73	9,148	286,195	279,928	566,123	500,000	376,888	876,888	3,898	0	44,747	500,000	500,000
30	74	9,148	296,045	310,250	606,295	500,000	411,214	911,214	3,898	0	42,581	500,000	500,000
31	75	9,148	305,585	342,929	648,514	500,000	447,768	947,768	3,898	0	39,511	500,000	500,000
32	76	9,148	314,825	378,035	692,860	500,000	486,609	986,609	3,898	0	35,323	500,000	500,000
33	77	9,148	323,810	415,488	739,298	500,000	527,602	1,027,602	3,898	0	29,845	500,000	500,000
34	78	9,148	332,585	455,443	788,028	500,000	570,780	1,070,780	3,898	0	22,762	500,000	500,000
35	79	9,148	341,190	497,964	839,154	500,000	616,174	1,116,174	3,898	0	13,981	500,000	500,000

The values illustrated are based on the assumption that the non-guaranteed elements, included dividends and current interest crediting rates, current mortality rates and current expense charges will continue unchanged for all the years shown. This is not likely to occur and the actual results may be more or less favorable than those shown.

Whole Life Versus Universal Life With Secondary Guarantees

A Comparison of Universal Life With A Secondary Guaranteed Death Benefit and Whole Life Insurance

		Whole Life Insurance						Universal Life					
		Guardian - Whole Life 100 - Age: 45 - Rate Class: Best Class						A Representative UL Policy - No Lapse Secondary Guaranteed Death Benefit UL - Age: 45 - Rate Class: Best Class					
Year	Age	Annual Premium	Base Policy Guaranteed Cash Value	Cash Value of Paid Up Additions	Total Cash Value	Base Policy Guaranteed Death Benefit	Paid Up Additions Death Benefit	Total Death Benefit	Annual Premium	Guaranteed Cash Value	Current Cash Value	Guaranteed Death Benefit	Current Death Benefit
36	80	9,148	349,620	543,167	892,787	500,000	663,861	1,163,861	3,898	0	3,935	500,000	500,000
37	81	9,148	357,830	591,195	949,025	500,000	713,987	1,213,987	3,898	0	0	500,000	500,000
38	82	9,148	365,755	642,210	1,007,965	500,000	766,782	1,266,782	3,898	0	0	500,000	500,000
39	83	9,148	373,325	696,212	1,069,537	500,000	822,337	1,322,337	3,898	0	0	500,000	500,000
40	84	9,148	380,495	753,484	1,133,979	500,000	880,972	1,380,972	3,898	0	0	500,000	500,000
41	85	9,148	387,280	814,074	1,201,354	500,000	942,807	1,442,807	3,898	0	0	500,000	500,000
42	86	9,148	393,720	877,809	1,271,529	500,000	1,007,617	1,507,617	3,898	0	0	500,000	500,000
43	87	9,148	399,880	944,700	1,344,580	500,000	1,075,292	1,575,292	3,898	0	0	500,000	500,000
44	88	9,148	405,860	1,014,760	1,420,620	500,000	1,145,704	1,645,704	3,898	0	0	500,000	500,000
45	89	9,148	411,770	1,088,002	1,499,772	500,000	1,218,679	1,718,679	3,898	0	0	500,000	500,000
46	90	9,148	417,735	1,164,516	1,582,251	500,000	1,294,029	1,794,029	3,898	0	0	500,000	500,000
47	91	9,148	423,920	1,244,717	1,668,637	500,000	1,371,826	1,871,826	3,898	0	0	500,000	500,000
48	92	9,148	430,505	1,328,512	1,759,017	500,000	1,451,526	1,951,526	3,898	0	0	500,000	500,000
49	93	9,148	437,755	1,416,224	1,853,979	500,000	1,532,722	2,032,722	3,898	0	0	500,000	500,000
50	94	9,148	445,825	1,508,165	1,953,990	500,000	1,615,152	2,115,152	3,898	0	0	500,000	500,000
51	95	9,148	454,810	1,604,795	2,059,605	500,000	1,698,786	2,198,786	3,898	0	0	500,000	500,000
52	96	9,148	464,600	1,706,342	2,170,942	500,000	1,783,753	2,283,753	3,898	0	0	500,000	500,000
53	97	9,148	474,895	1,812,558	2,287,453	500,000	1,870,118	2,370,118	3,898	0	0	500,000	500,000
54	98	9,148	484,915	1,919,938	2,404,853	500,000	1,956,196	2,456,196	3,898	0	0	500,000	500,000
55	99	9,148	500,000	2,017,838	2,517,838	500,000	2,017,837	2,517,837	3,898	0	0	500,000	500,000

The values illustrated are based on the assumption that the non-guaranteed elements, included dividends and current interest crediting rates, current mortality rates and current expense charges will continue unchanged for all the years shown. This is not likely to occur and the actual results may be more or less favorable than those shown.

Whole Life Versus Universal Life With Secondary Guarantees

A Comparison of Universal Life With A Secondary Guaranteed Death Benefit and Whole Life Insurance

Year	Age	Whole Life Premium		Whole Life Guaranteed Fungible Cash Rate Value of Return Analysis			Whole Life Total Fungible Cash Rate of Return Analysis			Whole Life Excess Death Benefit Rate of Return Analysis		
		Annual Premium	Annual Premium	Whole Life Premium Minus UL Premium	Whole Life Base Policy Guaranteed Cash Value	Rate of Return	Whole Life Premium Minus UL Premium	Whole Life Total Cash Value	Rate of Return	Whole Life Premium Minus UL Premium	Whole Life Death Benefit Minus UL Death Benefit	Rate of Return
1	45	9,148	3,898	5,250	0	N/A	5,250	0	N/A	5,250	0	N/A
2	46	9,148	3,898	5,250	0	N/A	5,250	100	N/A	5,250	100	N/A
3	47	9,148	3,898	5,250	8,465	-27.98%	5,250	8,701	-26.87%	5,250	404	N/A
4	48	9,148	3,898	5,250	17,705	-6.71%	5,250	18,421	-5.17%	5,250	1,093	N/A
5	49	9,148	3,898	5,250	27,135	1.11%	5,250	28,701	2.99%	5,250	2,652	N/A
6	50	9,148	3,898	5,250	37,020	4.63%	5,250	39,848	6.76%	5,250	5,086	N/A
7	51	9,148	3,898	5,250	47,090	6.20%	5,250	51,644	8.52%	5,250	8,431	-37.48%
8	52	9,148	3,898	5,250	57,335	6.89%	5,250	64,136	9.36%	5,250	12,732	-27.60%
9	53	9,148	3,898	5,250	67,740	7.13%	5,250	77,352	9.73%	5,250	18,022	-20.20%
10	54	9,148	3,898	5,250	78,275	7.15%	5,250	91,327	9.86%	5,250	24,332	-14.63%
11	55	9,148	3,898	5,250	88,950	7.05%	5,250	106,112	9.87%	5,250	31,691	-10.41%
12	56	9,148	3,898	5,250	99,750	6.89%	5,250	121,754	9.79%	5,250	40,119	-7.18%
13	57	9,148	3,898	5,250	110,690	6.70%	5,250	138,291	9.68%	5,250	49,614	-4.67%
14	58	9,148	3,898	5,250	121,775	6.51%	5,250	155,783	9.55%	5,250	60,160	-2.71%
15	59	9,148	3,898	5,250	133,000	6.31%	5,250	174,309	9.42%	5,250	71,807	-1.16%
16	60	9,148	3,898	5,250	144,360	6.11%	5,250	193,891	9.28%	5,250	84,565	0.08%
17	61	9,148	3,898	5,250	155,825	5.92%	5,250	214,604	9.14%	5,250	98,479	1.08%
18	62	9,148	3,898	5,250	167,385	5.74%	5,250	236,524	9.01%	5,250	113,632	1.91%
19	63	9,148	3,898	5,250	178,995	5.56%	5,250	259,733	8.88%	5,250	130,132	2.59%
20	64	9,148	3,898	5,250	190,640	5.39%	5,250	284,280	8.76%	5,250	148,048	3.17%
21	65	9,148	3,898	5,250	201,450	5.19%	5,250	309,330	8.62%	5,250	167,373	3.65%
22	66	9,148	3,898	5,250	212,235	5.00%	5,250	335,806	8.49%	5,250	188,149	4.05%
23	67	9,148	3,898	5,250	222,990	4.82%	5,250	363,787	8.37%	5,250	210,440	4.39%
24	68	9,148	3,898	5,250	233,730	4.66%	5,250	393,250	8.26%	5,250	234,162	4.67%
25	69	9,148	3,898	5,250	244,445	4.50%	5,250	424,342	8.15%	5,250	259,363	4.90%
26	70	9,148	3,898	5,250	255,110	4.35%	5,250	457,074	8.05%	5,250	286,085	5.10%
27	71	9,148	3,898	5,250	265,665	4.21%	5,250	491,585	7.96%	5,250	314,486	5.26%
28	72	9,148	3,898	5,250	276,055	4.07%	5,250	527,888	7.87%	5,250	344,678	5.41%
29	73	9,148	3,898	5,250	286,195	3.94%	5,250	566,123	7.78%	5,250	376,888	5.53%
30	74	9,148	3,898	5,250	296,045	3.81%	5,250	606,295	7.70%	5,250	411,214	5.63%
31	75	9,148	3,898	5,250	305,585	3.68%	5,250	648,514	7.62%	5,250	447,768	5.73%
32	76	9,148	3,898	5,250	314,825	3.56%	5,250	692,860	7.55%	5,250	486,609	5.81%
33	77	9,148	3,898	5,250	323,810	3.44%	5,250	739,298	7.48%	5,250	527,602	5.87%
34	78	9,148	3,898	5,250	332,585	3.32%	5,250	788,028	7.41%	5,250	570,780	5.93%
35	79	9,148	3,898	5,250	341,190	3.21%	5,250	839,154	7.34%	5,250	616,174	5.97%

The values illustrated are based on the assumption that the non-guaranteed elements, included dividends and current interest crediting rates, current mortality rates and current expense charges will continue unchanged for all the years shown. This is not likely to occur and the actual results may be more or less favorable than those shown.

Whole Life Versus Universal Life With Secondary Guarantees

A Comparison of Universal Life With A Secondary Guaranteed Death Benefit and Whole Life Insurance

Year	Age	Whole Life Premium		Whole Life Guaranteed Fungible Cash Rate Value of Return Analysis			Whole Life Total Fungible Cash Rate of Return Analysis			Whole Life Excess Death Benefit Rate of Return Analysis		
		Annual Premium	Universal Life Annual Premium	Whole Life Premium Minus UL Premium	Whole Life Base Policy Guaranteed Cash Value	Rate of Return	Whole Life Premium Minus UL Premium	Whole Life Total Cash Value	Rate of Return	Whole Life Premium Minus UL Premium	Whole Life Death Benefit Minus UL Death Benefit	Rate of Return
36	80	9,148	3,898	5,250	349,620	3.10%	5,250	892,787	7.28%	5,250	663,861	6.01%
37	81	9,148	3,898	5,250	357,830	3.00%	5,250	949,025	7.21%	5,250	713,987	6.03%
38	82	9,148	3,898	5,250	365,755	2.90%	5,250	1,007,965	7.16%	5,250	766,782	6.06%
39	83	9,148	3,898	5,250	373,325	2.80%	5,250	1,069,537	7.10%	5,250	822,337	6.07%
40	84	9,148	3,898	5,250	380,495	2.71%	5,250	1,133,979	7.04%	5,250	880,972	6.09%
41	85	9,148	3,898	5,250	387,280	2.61%	5,250	1,201,354	6.99%	5,250	942,807	6.10%
42	86	9,148	3,898	5,250	393,720	2.52%	5,250	1,271,529	6.93%	5,250	1,007,617	6.10%
43	87	9,148	3,898	5,250	399,880	2.43%	5,250	1,344,580	6.88%	5,250	1,075,292	6.11%
44	88	9,148	3,898	5,250	405,860	2.34%	5,250	1,420,620	6.83%	5,250	1,145,704	6.10%
45	89	9,148	3,898	5,250	411,770	2.26%	5,250	1,499,772	6.78%	5,250	1,218,679	6.10%
46	90	9,148	3,898	5,250	417,735	2.18%	5,250	1,582,251	6.73%	5,250	1,294,029	6.08%
47	91	9,148	3,898	5,250	423,920	2.11%	5,250	1,668,637	6.68%	5,250	1,371,826	6.07%
48	92	9,148	3,898	5,250	430,505	2.05%	5,250	1,759,017	6.64%	5,250	1,451,526	6.05%
49	93	9,148	3,898	5,250	437,755	1.99%	5,250	1,853,979	6.59%	5,250	1,532,722	6.03%
50	94	9,148	3,898	5,250	445,825	1.95%	5,250	1,953,990	6.55%	5,250	1,615,152	6.00%
51	95	9,148	3,898	5,250	454,810	1.91%	5,250	2,059,605	6.51%	5,250	1,698,786	5.97%
52	96	9,148	3,898	5,250	464,600	1.88%	5,250	2,170,942	6.48%	5,250	1,783,753	5.93%
53	97	9,148	3,898	5,250	474,895	1.85%	5,250	2,287,453	6.44%	5,250	1,870,118	5.90%
54	98	9,148	3,898	5,250	484,915	1.82%	5,250	2,404,853	6.41%	5,250	1,956,196	5.86%
55	99	9,148	3,898	5,250	500,000	1.83%	5,250	2,517,838	6.36%	5,250	2,017,837	5.78%

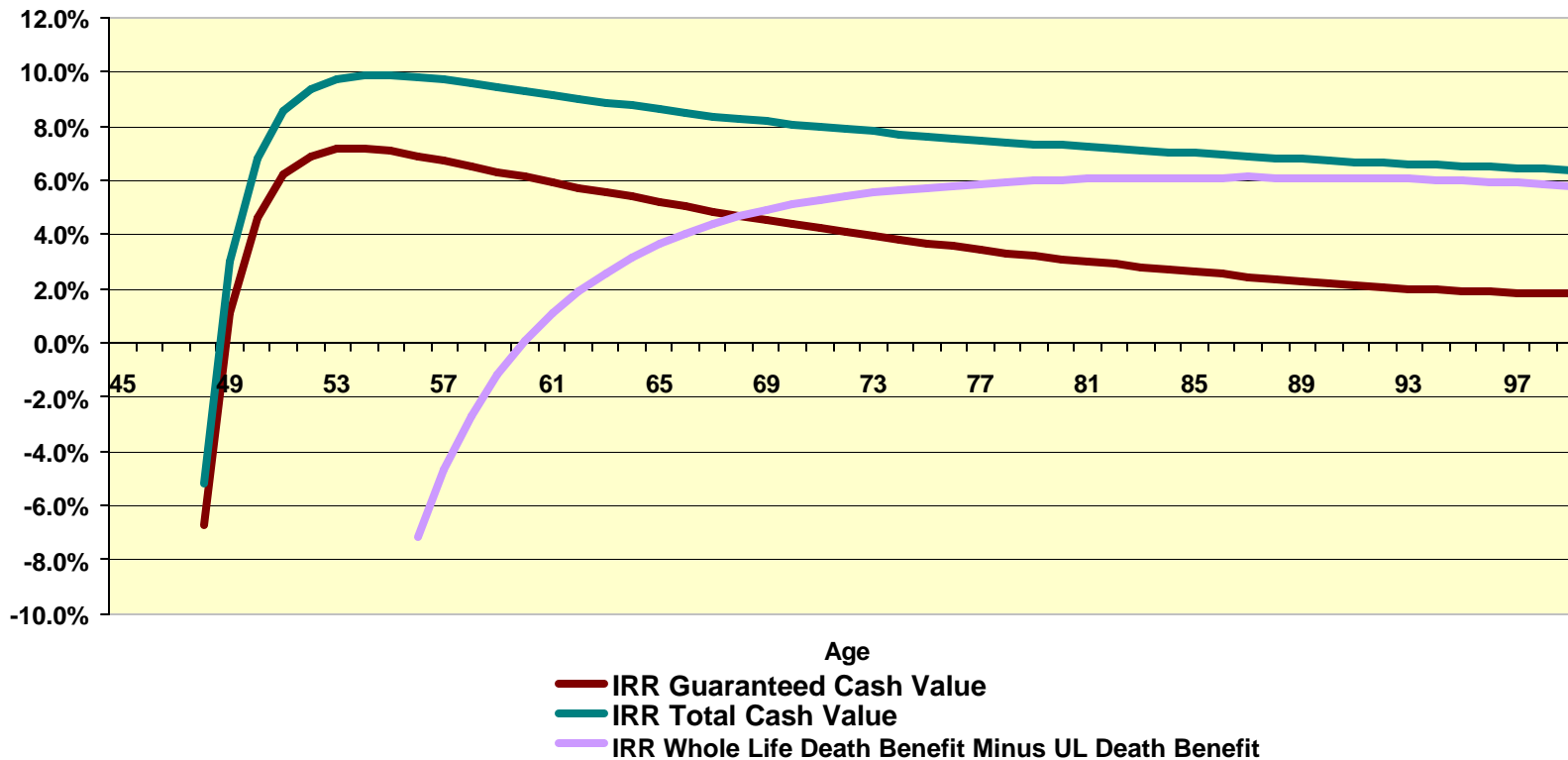
The values illustrated are based on the assumption that the non-guaranteed elements, included dividends and current interest crediting rates, current mortality rates and current expense charges will continue unchanged for all the years shown. This is not likely to occur and the actual results may be more or less favorable than those shown.

Whole Life Versus Universal Life With A Guaranteed Death Benefit

This analysis takes the difference in premium between a whole life policy and a universal life policy and illustrates the rate of return the premium differential must be invested at in order to develop the guaranteed cash value, total cash value and additional death benefit provided by the whole life policy.

***Guardian - Whole Life 100 - Age: 45 - Rate Class: Best Class
A Representative UL Policy - No Lapse Secondary Guaranteed Death Benefit UL - Age: 45 - Rate Class: Best Class***

Internal Rate of Return Analysis



This page is not valid without the Guardian illustration on pages 14 and 15 showing guaranteed values and other important information. The values illustrated are based on the assumption that the non-guaranteed elements, included dividends and current interest crediting rates, current mortality rates and current expense charges will continue unchanged for all the years shown. This is not likely to occur and the actual results may be more or less favorable than those shown.

VI. Additional Concerns: The Long-Term Financial Implications for the Insurance Company that Issues Universal Life Insurance Policies with No-lapse Secondary Guaranteed Death Benefits.

Prior to the advent of secondary guarantees, the risk of a universal life policy lapsing due to inadequate premium funding, declining interest crediting rates and/or rising mortality cost of insurance charges and rising policy expense charges was born by the policyholder. Consumer dissatisfaction with losses experienced on traditional universal life policies gave rise to the current generation of no-lapse policies in which the risk of policy lapse due to adverse interest rate and expense experience is now carried entirely by the insurance company.

The lifetime death benefit risk that insurance companies assume with no-lapse universal life policies is now the same type of risk that they assume with whole life policies, except the insurance company now assumes the risk under a universal life policy with 55% to 65% less premium than is required under a whole life policy.

Lower premiums are touted as an advantage to the consumer. However, if the premium has been lowered to an imprudent level, then the insurance company's financial health and its status as an on-going concern are threatened. The long-term solvency and profitability of an insurance company must be a major concern for the insurance purchaser. Life insurance policies are long-term contracts, purchased with the intention of keeping them in force for the life of the insured. Routinely, life policies are in force for fifty years or more. The only way an insurance company can stay in business to honor the commitments it makes to policyholders is to remain profitable and solvent. It is to this issue that two rating agencies, Moody's Investors Service¹ and Fitch Ratings² addressed themselves in July of 2004. As well, in the March/April 2004 and the October 2004 issues of the Insurance Forum³, the editor, Joseph M. Belth, Ph.D addressed this topic.

Both Moody's Investors Service and Fitch Ratings are concerned that the pricing of universal life policies with no-lapse secondary guarantees is inadequate and could potentially cause large losses for insurance companies in the future.

Moody's

Moody's has stated their concern about the impact of no-lapse universal life with secondary guarantees on the statutory reserve requirements and profitability of life insurers that are aggressively selling death benefit oriented UL policies as follows:

“Moody's fears that insurers writing these policies could suffer potentially large losses if aggressive pricing assumptions involving portfolio yield,

¹ Moody's Investors Service, *Beware of What You Price For: Credit Implications of UL Secondary Guarantees for U.S. Life Insurers*, Special Report, Global Credit Research, July 2004

² Fitch Ratings, Ltd, *Looming Financial Implications of Universal Life*, Special Report, July 21, 2004

³ Joseph M. Belth, Ph.D, *Secondary Guarantees, Marketers, Actuaries, Regulators, and a Potential Financial Disaster for The Life Insurance Business*, The Insurance Forum, Vol. 31, Nos. 3 & 4, March/April, 2004; *The Magnitude of the Underpricing in Universal Life Policies With No-Lapse Guarantees*, The Insurance Forum, Vol 31, No 10, October, 2004

Whole Life Versus Universal Life With Secondary Guarantees

surrender rates, letter of credit (LOC) cost and mortality rates do not materialize as expected.’⁴ [Emphasis in the original.]

Fitch

Fitch Ratings has voiced the same type of concerns over the pricing and reserving of UL policies with secondary guaranteed death benefits and their potential to degrade the financial profitability and stability of insurance companies:

“The increase in UL sales [Annual sales of UL products grew by 28% in 2003.] was influenced by two factors. First, fixed rate life products have benefited from the recent bear market as policyholders have sought capital preservation. Second, newly designed UL products with “secondary guarantees” have struck a positive chord with policyholders, allowing for the extension of insurance coverage beyond normal terms, subject to premium conditions.

However, these secondary guarantees create both a pricing and reserving risk. Specifically, certain product designs create pricing risk, in that insurers may be limited in their ability to adjust interest crediting rates and cost of insurance to maintain profitability. Pricing assumptions appear to have excessive lapse assumptions, aggressive mortality underwriting and higher implied crediting rates than are warranted. Obviously, this pricing environment can create significant risk if these assumptions do not hold. In addition, insurers face antiselection if they sit on rates to re-coup prior losses, and healthier lives lapse to pursue the lowest price available, leaving riskier lives with insurers.”⁵

The Insurance Forum

Joseph M. Belth, Ph.D., professor emeritus of insurance in the Kelley School of Business at Indiana University (Bloomington) and editor of *The Insurance Forum* is also concerned about the long-term effects of universal life upon the financial health of life insurance companies and the potential disaster they may be to insurance companies. He recently described and quantified the problem in two articles in his newsletter.

The article entitled, “Secondary Guarantees, Marketers, Actuaries, Regulators, and a Potential Loss Financial Disaster for the Life Insurance Business” in the March/April 2004 issue discusses the underpricing of universal life policies with no-lapse guarantees in general terms. This was followed up in the October 2004 issue of *The Insurance Forum* by an article entitled “The Magnitude of the Underpricing in Universal Life Policies with No-Lapse Guarantees” that quantifies the extent to which an insurance company could suffer losses from no-lapse universal life policies.

Dr. Belth’s comments can be summed up by the following quote:

“Many universal life policies today are being sold with a so-called secondary guarantee – a promise to continue the protection for the life of the insured irrespective of the size of the account value, provided that certain scheduled level

⁴ Moody’s Investors Service, *Beware of What You Price For: Credit Implications of UL Secondary Guarantees for U.S. Life Insurers*, Special Report, Global Credit Research, July 2004

⁵ Fitch Ratings, Ltd, *Looming Financial Implications of Universal Life*, Special Report, July 21, 2004

Whole Life Versus Universal Life With Secondary Guarantees

premiums are paid. The scheduled level premiums often are far below the level premiums for otherwise comparable traditional whole life policies.

The reserves established for universal life policies with secondary guarantees appear small and the scheduled level premiums appear inadequate. A life insurance policy is a long-term instrument – many policies remain in force more than 50 years – and the impact of small reserves and inadequate premiums sometimes is not felt for many years.

Marketers, anxious to increase new business and generate large sales commissions, press insurers to issue policies with low premiums. Actuaries figure out how to minimize reserves and justify low premiums. Regulators allow the policies to be sold. The individuals in those groups share responsibility for the current widespread use of policies with small reserves and inadequate premiums. Those individuals will no longer be associated with the life insurance business when the devastating financial consequences of the policies now being foisted on the public will have to be confronted by subsequent generations of marketers, actuaries, and regulators.’⁶

⁶ Joseph M. Belth, Ph.D., *Secondary Guarantees, Marketers, Actuaries, Regulators, and a Potential Financial Disaster for The Life Insurance Business*, 31 *The Insurance Forum*, 21-30, (2004)