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Index Universal Life Insurance

Beware of a possible new scam.
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Current assumption universal life insurance refers to cash value policies whose future performance depends on future interest crediting rates. If crediting rates decrease this would mean policyowners should raise their target premiums. If crediting rates increase, premiums could be decreased. When making a purchase decision, generally the higher the crediting rate the better the proposal appears. But consumers and advisers need to be wary of illustration tricks that may make some proposals look better.

During the late 1980s and 1990s many companies used illustration gimmicks to make their policies appear to have fewer premiums or create higher values than their current pricing could provide. The most common techniques used included:

- Bonus interest in five or 10 years;
- Lapse-supported pricing; and
- Return of mortality costs after 10 years or 20 years.

The illustration wars of the 1980s and 1990s were such a problem that the life insurance industry finally moved to curtail such abuses by promulgating model regulations for life insurance illustrations in 2001. Under the regulations, interest rates embedded into the illustrations are not supposed to be "… greater than the earned interest rate underlying the disciplined current scale." The *disciplined current scale* requires insurers to use non-guaranteed elements that are "… reasonably based on actual recent historical experience …"

The new version of illustration *liar's poker* appears to be index universal life. *Index* refers to interest crediting rates that are determined by reference to the S&P 500 stock index. The problem is that index premiums collected are not being invested in the S&P 500. For example, one company selling a good deal of index universal life has an investment portfolio containing 97 percent fixed income instruments. The sellers of index universal life claim they are able to provide such high potential returns by using various hedging techniques to cover returns that are much larger than what their investment portfolios appear could be produced. Even if companies have actually designed hedging formulas, such exotic strategies are notoriously inaccurate. MF Global being the most recent example of how financial wizards often outsmart themselves. They certainly are an unfair mirage advantage over conventional current assumption universal life policies.

Downside of Index Universal Life Insurance Policies

Index universal life insurance policies are being used in conjunction with premium financing and this could turn into a disaster for buyers. Premium financing promises free life insurance by financing all premiums and interest costs, with the loan being paid back via the death benefits and the net death benefits going to the policy's beneficiary. The collateral requirements of the lender exceed the cash values and buyers end up defaulting and having to pay back the huge loans. This has always been completely unexpected. I had one case in which the additional collateral was going to consume the insured's entire net worth within another six years, taking him to age 86, well within his life expectancy.

The premium finance proposals look great because index universal life uses a higher illustrated crediting rate than the assumed interest costs to finance premiums and the interest. This makes the premium financing sale spreadsheets appear to provide permanent life insurance regardless how long insureds live.

Conclusion

As a CPA adviser, throw caution to the wind and be wary of index universal life claims and conduct thorough research before advising clients, especially when the high illustrated crediting rates are an integral part of a proposed premium financing proposals.

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