Universal Life Insurance, a 1980s Sensation, Has Backfired

A long decline in interest rates caused premiums to soar when they were supposed to stay level

--Appeared in the September 20, 2018, print edition as '*Insurance Policies Backfire On Retirees.*'

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Updated Sept. 19, 2018 10 54 a.m. ET

A popular insurance product of the 1980s and 1990s has come back to bite many older Americans.

Universal life was a sensation when it premiered, and for some years it worked as advertised. It included both insurance and a savings account that earns income to help pay future costs and keep the premium the same.

That was when interest rates were in the high single digits or above. Today, rates are completing a decade at historically low levels, crimping the savings accounts. Meanwhile, the aging of the earliest customers into their 70s, 80s and even 90s has driven the yearly cost of insuring their lives much higher.

The result is a flood of unexpectedly steep life-insurance bills that is fraying a vital safety net. Some find they owe thousands of dollars a year to keep modest policies in effect. People with million-dollar policies can owe tens of thousands annually. Some retirees are dropping policies on which they paid premiums for decades.

"I'm very scared that everything will go down the drain," said Bernice Sack, a 94-year-old former hospital billing clerk in North Carolina.

A $56 monthly premium Mrs. Sack paid when she bought the policy 35 years ago has climbed to $285, despite her efforts to keep the cost down by reducing her death benefit. Living with a daughter and getting by on Social Security, she skimps on medications to pay the insurance bill, sometimes runs late on her share of household costs and considers ice cream a splurge.

John Resnick, co-author of an American Bar Association book on life insurance, said of hundreds of older policies he has reviewed over a decade, "easily 90% or more actually were in trouble or soon to be in trouble." Many people "are sitting on a ticking time bomb, and most probably aren't aware of it," he said.

Universal life is among the reasons Americans are approaching retirement in the worst shape in decades. The insurance policy type emerged in an era nearly four decades ago when the Federal Reserve was fighting inflation with high interest rates. Some financial advisers suggested people forgo traditional “whole life” insurance and buy less-expensive policies that covered just a limited term, investing what they saved in the mutual funds and money-market funds then proliferating. Insurance companies embraced this mantra of “buy term and invest the difference” by inventing a new product.

With universal life, the customer buys a one-year term-insurance policy and renews it annually. In the early years, the premium the customer pays is a good deal more than the actual cost of the insurance. The excess goes into a tax-deferred savings account.

The policies are designed so the gains in the savings account, which the industry typically calls a “cash-value” account, offset part of the cost of renewing the term insurance each year.

Much depends on what interest rate the account is earning. When these policies first were sold, U.S. interest rates were unusually high, and insurers often illustrated the policies to potential customers using a scenario of continuous 10% to 13% rates.

Companies typically showed worst-case scenarios, too. But with high rates common, the worst-case scenarios often got short shrift.

The interest projections were proving unrealistic by the mid-1990s, and especially so after the 2008 financial crisis depressed rates. Although many policies didn’t allow the savings-account return to fall below 4% or 5%, that wasn’t enough for early customers. The cost of a year of term insurance soars once people reach their late 70s.

Compounding the problem, universal life offers flexibility that is alluring but dangerous. Within reason, customers plan their own monthly or annual premium payment. They can set it low, counting on high interest income in their savings account to keep the policy financially sound.

Customers also can choose to pay less than their planned premium sometimes if money is tight. Or they can skip a payment altogether. And they can borrow against their savings account.

Any such move, of course, will spell skimpier earnings in the account. It is widely accepted that not all customers—or even all insurance agents—fully understood years ago how borrowing or skipping payments could undermine a universal-life policy.

Defending their sales, insurers say they have paid out more than $150 billion on universal-life policies, and some owners received value from their policies by borrowing from them. Insurers stress that materials given to customers say only a minimum interest rate is guaranteed; higher rates used in sales pitches are hypothetical.

Insurers send customers annual statements showing the change in the value of their savings account and what it has cost to renew their term insurance. Some companies seek to identify problematic older policies, sending customers extra communications to be sure they understand their situation.

“Lincoln annually provides all policyholders with an updated statement that they and their agent can, and should, use to manage their policy and assess how various activities including withdrawals, missed payments and loans may impact its value,” said Scott Sloat, a spokesman for Lincoln National Corp. , the company that sold Mrs. Sack her policy.

He said Lincoln sends additional letters to customers who could face a large, sudden jump in their premium in 10 years or sooner if they don’t take action, such as by voluntarily increasing premium payments or reducing the policy’s death benefit.

Nicholas Vertullo, an 85-year-old former high-school teacher outside New York City, has three universal-life policies issued by a unit of American International Group Inc. One of them initially earned 9% on its savings account. The policies’ accounts today fetch 4% to 4.5% interest.

“I was abstractly aware that interest rates could vary,” Mr. Vertullo said. After the 2008 financial crisis, “the whole thing came home in a way that it was no longer an abstraction.... These life policies were quicksand.”

For death benefits totaling about $475,000, Mr. Vertullo is paying about $30,000 a year, triple the original premiums.

He had planned to replace the income his wife will lose when, on his death, his teacher's pension and Social Security check stop. Years ago, he cut the death benefit to repay a loan against the insurance, and now he is looking into a bigger cut to reduce his annual cost. Mr. Vertullo said he and his wife have forgone restaurant meals and travel, living "an austere and Spartan retirement."

"I hate to confess this: I simply went along," Mr. Vertullo said. "I don't think I understood completely what the hell I was doing."

AIG said it doesn't comment on individual situations. It said universal life is one of a wide range of solutions it offers to meet families' specific needs.

In the early years of universal life, buyers often were businesspeople and other professionals who found the tax-deferred interest feature attractive. The insurance industry's reputation for conservative products helped allay skepticism. By 1985, universal life was generating 38% of the industry's premiums for individual life policies, according to research firm Limra. Americans bought two million to three million universal-life policies a year in the 1980s and early 1990s.

Nicholas and Grace Vertullo in the 1980s **PHOTO:** VERTULLO FAMILY

As interest rates declined, some agents alerted owners that funding shortfalls were developing. One who did was Pennsylvania agent Allen Carr, who says he had been "gullible" to believe universal-life policies could be counted on to work as planned. When policies he had sold veered from their projected performance, Mr. Carr said, "it was embarrassing going back [to customers] saying, 'We have a potential problem.'"

Industrywide, some customers angrily canceled their policies. Others took a shame-on-me attitude for not having read the details. Some began voluntarily paying larger premiums to put the policies on firmer financial footing.

Lawsuits arose, and from the mid-1990s to early 2000s plaintiffs' lawyers reached settlements over allegedly deceptive sales practices, such as promising the savings buildup would eliminate

the need to pay premiums at all in a decade or so. State regulators tightened rules on how insurers could illustrate the policies, including requiring them to cite interest rates that could be justified for the long haul.

The industry responded by offering a new wrinkle: guaranteed universal life, which had a fixed premium designed to ensure lifetime coverage if paid on time. Many early universal-life policyholders swapped into this.

The disappointed early buyers of universal life included people in the industry—a gauge of how poorly the policies often were understood. Early this year, MetLife Inc. alerted Ohio couple Thomas and Rebecca Bell they would need to start paying about $300 a month on a policy for which they had been paying $97 monthly since they acquired it in 1994. At that time, Mr. Bell was an insurance agent.

The Bells owned a universal-life version with some added twists and risk, "variable universal life," which let them invest the savings in stock and bond funds. After having paid $26,000 in premiums over the years, the couple let the $25,000 policy lapse. "There was no way [a $300 monthly premium] would be in our budget," said Ms. Bell, 79.

Her 86-year-old husband, who was a tools salesman in addition to selling insurance, said he didn't remember much about the policy's particulars, but "It's not what I expected it to be."

A MetLife spokeswoman said, "We understand it can be challenging to cover the cost of insurance" when a policy contains less built-up income than envisioned. She said MetLife updates policyholders annually on their accounts' value and urges them to contact their agents or the company.

The tumble in interest rates didn't affect just customers—it also dinged insurers' profits. As corporate-bond yields fell below 5% in recent years, insurers earned less from investing premiums, yet still had to pay guaranteed minimums of around 4% on universal-life savings accounts.

With future profits expected to be hurt by low rates, at least a half-dozen insurers have invoked policy provisions that they say allow them to raise the rates used to calculate the annual cost of customers' term insurance, according to ITM TwentyFirst, which provides policy-management services.

This means some customers see costs rising not simply because they are a year older, or because their savings account didn't grow as planned, but because their insurer has changed its price formula. As a result, even some customers who kept their policies well funded are being hit with unexpectedly higher costs.

One is Douglas Bradley, 83, a longtime health-insurance broker in California, whose premium roughly doubled because of a change made by insurer Transamerica. “I am absolutely stupefied at this,” Mr. Bradley said.

Transamerica, a unit of Aegon NV, declined to comment on Mr. Bradley’s situation but said its change was contractually permitted.

Such increases are “causing more life-insurance policies to expire even quicker than before” as customers who can’t afford them drop their policies and hand insurers “windfall profits,” said Henry Montag, a principal with The TOLI Center East in Melville, N.Y., which evaluates policies held in trusts.

Mrs. Sack, the 94-year-old retired hospital billing clerk, was warned by her insurance agent in 2000 that the universal-life policy she bought in 1983 was financially off track.

Mrs. Sack had borrowed a little over $4,000 from it and had skipped some payments. Also, while the policy’s savings account initially earned over 10%, by 2000 this was down to 5.7%. She lowered the death benefit to $21,000 from $25,000 to repay the loan but still had to nearly double her premium, to $100 a month.

> The premium kept rising. She borrowed a few thousand dollars more from the policy, and the interest return continued to slide, to the 4% minimum.

Her experience is detailed in an inch-thick stack of documents, bills and correspondence, with scribbled names of Lincoln National representatives she and her daughters have spoken to in their efforts to figure out the situation.

Mrs. Sack complained last year to North Carolina’s insurance department. It responded that “we understand your frustrations” but that the company appeared to be in compliance with policy provisions.

Even though Mrs. Sack has paid more for the insurance—approximately $39,000—than her heirs will ultimately receive, she doesn’t dare stop paying and let it lapse.

“My prime concern is my burial,” Mrs. Sack said. “My children are all so supportive, but I don’t want them to pay for mine.”

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