

Separate Insurance and Savings Products

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Universal Life – an exercise in deception

No matter how appealing the presentation, no matter how gripping the accompanying illustration, if a life insurance agent or broker approaches you with the recommendation that in order to effectively fund your retirement you should acquire a life insurance policy and then pump into it as much premium as you can afford, beware.

What this risk-laden strategy invariably conceals is more critical than what it reveals and for success depends primarily upon the performance of **an un-guaranteed** insurance product, namely, the **Universal Life** insurance policy.

Yet today promotion of this product for just such a retirement strategy is commonplace and being conducted with increasing creativity and intensity by insurance agents, brokers, and financial planners. In the process, many otherwise astute business people and professionals, evidently **blinded by the promise of a 'tax sheltered investment,'** are being attracted to these strategies before investigating whether there are more productive and secure alternatives. There are.

Bearing in mind the old adage 'if it sounds too good to be true it usually is,' let us consider the product, determine whether 'full disclosure' is being provided in the sale of this retirement investment strategy, and whether it merits the hype it now receives.

A Universal Life policy is an extremely complex product that is poorly understood by most insurance practitioners and policy-owners alike, let alone lawyers and accountants. At a recent brokers' educational seminar an insurance carrier in its promotional summary described Universal Life as an 'enigma', but also "a powerful and capital-efficient financial tool **which, in the hands of an amateur is subject to disastrous results.**" Gross exaggeration about U.L. aside, putting the comment about "amateur" in perspective an insurance company executive recently told me he figured that **98%** of agents and brokers do not understand Universal Life! (Neophytes from the investments industry have now worsened the situation).

In reality U.L. is nothing more than an **adjustable Whole Life cash value policy**, but its composition lends it to the dishonest 'creativity' and deception that now so often characterizes its promotion and sale. It is a policy in which life insurance companies reserve the right to unilaterally 'adjust' the contract should their various actuarial calculations and assumptions fail to live up to expectations. Among these, but not limited to them, are: policy lapse assumptions, interest rate assumptions, mortality assumptions, premium taxes, etc. Further, under certain conditions insurers reserve the right to change the amount of life insurance coverage, premiums being paid, even to lapse the policy.

Consumers should not be misled by insistence that because one or a few components are guaranteed, this makes it a guaranteed policy. **That's not the case at all.** Plain and simple, unless all of the components in a policy are guaranteed, the policy is not guaranteed.

If you doubt these revelations, simply read a U.L. policy yourself but I caution you to do so very, very carefully. This exercise alone should tell consumers who ultimately controls the policy. It certainly is not the policy owner.

Add to this the fact that an ever-increasing number of insurers insist that before taking possession of their U.L. policy, the new

owner must sign a 'disclosure' form (in fact it's a disclaimer) acknowledging, in effect, they understand that their policy might not work out quite the way it was explained to them. Think about that! (The other person who must sign the 'discloser' is the advisor - and thus insurers limit their liability).

Upon being asked by a U.L. policy owner for a written guarantee that his policy would never lapse, one Canadian insurer's actuary wrote to the man and assured him that provided he adhered to 12 conditions listed in the letter, his policy would never lapse.

Amazingly, having listed the conditions the actuary concluded with: **"Finally, even if all the above conditions are respected, (we) cannot guarantee that the policy will not lapse if future government taxes are implemented and adversely affect the values of the above policy. I hope all is to your entire satisfaction."** What a way to end a letter. Why would the client be satisfied?

Well, isn't all of this terrific! If we ever needed evidence that insurers are still haunted by the vanishing premiums' class action lawsuits that discredited their "*participating*" Whole Life policies that contain fewer variables than a Universal Life, this is it! That aside, **why would consumers knowingly sign a document that denies them their rights and relieves an insurance company of accountability?**

In its simplest form a Universal Life policy consists of life insurance and a cash value accumulation, created by investments, but while the illusion given is that these two components exist independent of each other, the catch-word being "unbundled", should a policy owner try to cancel one while retaining the other they will quickly discover how interdependent they truly are.

As an investment vehicle, a Universal Life policy is a poor one. Certainly it provides more investment options than did the original Whole Life policy and these grow tax-sheltered (**as they do in all cash value policies**), but should the cash accumulation fund be withdrawn before the insured's death the entire proceeds are subject to a

policy gains tax, which is applied at an individual's maximum marginal tax rate.

Further, there is no chance that the returns in its investments component will match those of independent investments. In the first place, U.L. policies are loaded with **charges and fees**, some exorbitant and many cunningly devised to relieve a policy owner of a portion of each premium paid. Should these deductions increase, the investment performance will be further adversely affected.

While **policy illustrations** frequently show 6%, 8%, 10% or even 12% net investment returns, (add 3% to 4% to such figures **to get at the real required gross return**) most companies don't guarantee more than 3% on guaranteed accounts. But then, little faith should be placed in those wondrous illustration projections. I've yet to see one that reflected reality or lived up to expectations.

Also less than thrilling is the discovery that dividends from a U.L. policy's linked or mirrored investments are not always returned to the account for reinvestment. Often they become the insurer's property.

And should a policy owner try to withdraw cash value or cancel the policy within its first 10 years (**sometimes less**), they will find themselves seriously discouraged by a surrender charge that almost invariably is 100%. Although it differs from one company to another, surrender charges can continue for as long as 15 years. Policy owners could also find that in the first few years little to nothing is available to them should they consider making a withdrawal.

IF YOU HAVE A GOOD POLICY, WHY ACQUIRE ANOTHER?

The much-vaunted strategy of using a U.L. policy's cash value to acquire a loan for tax-free retirement income, preferably after the policy's 15th year (a concept misleadingly called an Insured Retirement Plan or IRP), initially appears enormously attractive. This becomes less so when it is revealed that in order to secure a loan financial institutions demand significant personal security, that

this will be reviewed annually, qualification requirements may change, and should the borrower's loan security not meet review requirements the financial institution can call the loan and **thus collapse this retirement strategy**. The policy owner is left to find money to repay the loan and could very well discover that after tax their policy's cash surrender value does not meet this unanticipated debt burden. There are more pitfalls, but I'll leave it there for now.

Consumers need to ask themselves this question: **'Why would an individual who already owns a good life insurance policy wish to acquire another (at an older age and thus at higher rates) in which they must pay for more (possibly unnecessary) life insurance, in order to acquire a mediocre to poor tax-sheltered investment for collateral to acquire a loan for tax-free retirement income?'**

It's less than helpful to criticize or condemn a product or strategy without recommending alternatives. So, simply put, **keep your insurance and investments in separate vehicles** to maximize the effectiveness of both.

If it is permanent insurance you want, then acquire one of the excellent, fully guaranteed, policies still available in Canada, but don't let anyone talk you into believing that a Universal Life policy is guaranteed - or permanent insurance.

For those bent on the leverage route, **acquire a fully guaranteed quick-pay permanent policy** and then through a change to the beneficiary arrange a viatical settlement which uses the death benefit, rather than the cash value, for security in much the same way as a reverse mortgage.

This method is completely guaranteed and achieves greater return for premiums invested. Corporate shareholders are eligible to further benefits from such an arrangement by avoiding any out-of-pocket cost with the necessary documentation.

Finally, when confronted with the Universal Life hype simply remember that while these policies are created and promoted by

actuaries, they are seldom purchased by them. Now, ask yourself, why is that?

R. J. (Bob) Porter

Crusader Insurance & Financial
6899 Postmaster Ridge,
Mississauga, Ontario. L5W 1C5

Tel: (905) 696-9480