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YOU BET YOUR LIFE

Why diligently paying insurance premiums may not be enough

By CLAUDE SOLNIK

Most people look at life insurance policies as reliable, sleepy documents tucked away in a drawer only relevant when they die. But interest rates are wreaking havoc on many policies whose premiums are based on those rates.

E.F. Hutton Life in 1982 began selling what's known as nonguaranteed universal or interest-rate-sensitive life insurance policies, which remained prevalent until 2003, when policies unaffected by interest rates became more common.

Nonguaranteed policies, however, are less expensive than guaranteed policies, making them attractive.

From 1983 to 2003, about 45 percent of policies sold were nonguaranteed interest-rate-sensitive policies, according to the Life Insurance Marketing Association based in Des Moines, Iowa.

After years of paying premiums, many people are finding their policies no longer perform as they expected, because low interest rates decrease the ability of cash paid to the policy to earn returns.

So after paying premiums diligently, they're receiving letters telling them to hike payments, possibly by five times, leading many to abandon policies.

"It is a time bomb and it's continuing to tick," said Henry Montag, principal of the TOLI Center, in Huntington Station, which evaluates the performance of life insurance policies. "With each passing day people hold on to nonguaranteed policies and pay the same premium they did 10 years ago; that's causing the insurance company to say, 'Based on the current interest rate and premium, you don't have enough to sustain your policy.'"

Ignorance is not bliss

While people often monitor stocks and bonds, they typically pay little attention to life insurance, continuing payments as is. Low interest rates are hitting these people and policies hard.

They mean existing payments aren't enough to sustain policies, based on the idea that money paid into policies will earn higher interest.

"You have to view your life insurance policy the way you would your investment account," said Lawrence Sprung, president of Mitlin Financial in Hauppauge.

Soon after E.F. Hutton created the interest-rate-sensitive, or nonguaranteed policy, in the early 1980s, the 10-year Treasury reached 15 percent, before beginning a decline to under 2 percent today.

"The combination of reduced interest rates and neglect over the last 25 years is causing an increasing number of these nonguaranteed policies to expire prematurely," Montag said.

Nonguaranteed means if interest rates go down, you have to pay higher premiums, but people aren't regularly informed by insurers that they must raise their premium or risk problems.

They typically continue paying existing premiums, only finding out later on that isn't enough.

Montag said a survey of 1,100 clients found 20 percent eventually stopped paying premiums, which became exorbitant due to reduced interest rates.

"The insurance companies are happy when policies expire. People who paid premiums for 25 years are being told they have to pay five times as much. They're letting policies lapse," Montag said. "That's music to the insurance companies' ears."

Disclosure documents

If people had adjusted premiums gradually as rates fell, they would have kept up to date. The failure to do so, as much as the drop in rates, is leading to the problem.

"People need to review their life insurance policies annually or at least every two years to make sure they're keeping up with what they were sold," said Lisa Marino, vice president of Marcum Financial Services with Long Island operations in Melville. "A lot of people get sold things. Other professionals go on to the next sale."

When insurance brokers sell policies, they often collect the commission upfront, with little or no money to follow. As a result, many don't monitor the impact of interest rates, if any.

"The insurance broker's responsibility is merely to distribute the policy," Montag continued. "The insurer's primary responsibility is to send out a statement and a bill. It's the owner of the policy's job to manage the policy."

Montag took out a client's four-page insurance statement with two lines toward the end, indicating an "important notice."

"Changes in interest rates may impact the insurance coverage and cash value objectives of your policy," the insurer wrote. "You may need to adjust your payment amount and/or death benefit to maintain your original objectives."

Montag said, even if the information is there, it's not placed prominently, making it easy to ignore.

"That's buried within five pages," he said. "Most people, when they get these reports, don't read them. That important notice often goes unheeded. In my opinion, that should be in large, bold letters."

Assumption junction

People who bought these policies 10 or 15 years ago are finding numerous assumptions aren't coming to fruition.

"We all know what happens when you assume," Sprung said.

He pointed to someone who began paying premiums at age 40 and was told by age 55 cash in the policy should pay premiums.

"We found that what they were told and sold wasn't accurate," Sprung continued. "They had to continue paying in for at least another 10 years before it would be in a position to sustain itself."

He said the problem isn't just that rates changed, but that few people were aware of the impact.

"There aren't any surprises if you review these things every 18 or 24 months," Sprung continued.

Other people find their policies don't perform as planned for other reasons. Marino said one client came to her after pouring $1 million into a policy, and being told that would be enough to pay future premiums.

Photo by Bob Giglione

HENRY MONTAG: 'People who paid premiums for 25 years are being told they have to pay five times as much. They're letting policies lapse. That's music to the insurance companies' ears.'

"The policy didn't perform the way they told him it would," she said, noting money in the policy was invested conservatively. "He has to put in $130,000 a year for it to be maintained for his life expectancy."

Life insurers as of the end of 2014 had $5.8 trillion invested, including $745 billion in government bonds, financing $386 billion mortgages and holding 20 percent of all U.S. corporate bonds, according to the Washington-based American Council of Life Insurers.

"I think it's part consumer awareness and part an insurance advisor not just selling the policy and walking away from it," Marino said of the need for people to track how their insurance money is invested and how it performs.

Longevity factor

While low interest rates create potential problems, there is good news for rates in the form of increased longevity.

"Increased longevity means insurance costs overall have gone down in the last 10-plus years," Sprung said. "The cost of insurance has gone down because people are living longer."

And it is possible to detect problems, by asking an insurer for an in-force illustration, showing how a policy performs compared to predictions.

Sprung said that's "complicated," but it will show you if your policy is at odds with projections.

"When your premium's not enough to cover the cost and you don't have the cash to make up the deficit, you can't pay enough to keep the policy afloat," Sprung said. "The insurance company will lapse the policy. It happens all the time."

People who monitor policies can adjust payments, if necessary, so they're not hit by a sudden need to pour in cash. But just as an unwatched pot boils over, an unwatched insurance policy can burn the insured.

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