THE LOWDOWN ON LIFE INSURANCE GIVEN COVID-19

The most significant factors in the pricing of a life insurance contract are the carrier's expectation of its insureds' life expectancies and the investment returns it earns on its portfolio of assets. The deaths resulting from COVID-19, and the extremely low interest rates resulting from the accompanying economic slowdown, have negatively impacted both of these factors. While some carriers have already announced an increase in their mortality charges on certain products (mortality charges represent the amount a carrier sets aside each year from a contract to meet anticipated future death claims), absent a prolonged outbreak, lower interest rates will likely have a more significant long term impact on contract pricing. (Life insurance carriers only recently replaced the 2001 Commissioners Standard Ordinary (CSO) mortality table with the more favorable 2017 CSO Table, which would normally be expected to contribute to a reduction in mortality charges.)

Lower interest rates have been a concern for insurance carriers for many years. "Permanent life insurance" describes any life insurance product with a cash surrender value. In permanent products such as whole life or universal life, the carrier keeps the policy cash value on its books and credits it with dividends or interest. The earnings credited are primarily a function of the return the carrier earns on its underlying portfolio of bonds and mortgages. As interest rates decline, so do the earnings credited, leading to poorer policy performance.

Stock market returns can also influence insurance policy performance. Products such as variable universal life insurance (VUL), where the cash value is segregated from the books of the carrier and the policy owner is free to invest in a selection of insurance-dedicated mutual funds, will perform in accordance with the investments selected. As the cash value in these policies is often invested in equity mutual funds, VUL policy owners may find that their cash values have declined so far in 2020. Indexed universal life insurance (IUL) is a variation on VUL that uses options on an index such as the S&P 500 to provide both a floor and a ceiling on investment returns credited to the contract. The cost of the options is a function of market conditions, including market volatility. In a volatile market such as the one we are currently experiencing, the cost of the index options increases and the carriers cannot offer as much protection for the same price. IUL policy owners, therefore, may find that in the future carriers will need to lower the ceilings on the returns credited to offset the increased cost.

Policy owners with any of these permanent life insurance products should ask their agent or broker for an in-force illustration under "current assumptions", and repeat the request at least annually. If the illustration reveals that the policy is not sustainable at current cash values and premium outlay, options include increasing the premium, lowering the death benefit, and exchanging the policy for a new policy. (As a general rule, policy owners with a policy issued under older CSO tables should consider asking their agent or broker whether an exchange into a new policy would make sense. The lower mortality charges on a new policy may, in the long run, more than offset any charges associated with purchasing it.)

Policy owners with large life insurance premiums sometimes finance the payments through third party loans that are collateralized by the policy cash value. While lower interest rates may lower the cost of the financing, if the expected cash value does not materialize, additional collateral may be required in the future. These policy owners should also consider asking their agent or broker for re-projections that include figures for the premium financing structure.

COVID-19 also has implications for potential buyers of new life insurance. Prospective buyers are finding that carriers are limiting the amount of new premium they will accept on a permanent policy. These limits could have an impact for buyers hoping to have a policy paid up in just a few years, or for those wishing to exchange the cash value from an existing policy into a new one. In a guaranteed universal life insurance policy (GUL), a product that has been popular for many years, the carrier guarantees a specified amount of death benefit for a predetermined number of years so long as an agreed upon amount of premium is paid annually. GUL has been offered by fewer and fewer carriers as interest rates have declined. It is likely that GUL will become even scarcer in the future. Buyers thinking about purchasing GUL may wish to act sooner rather than later.

For new policies, there is both good and bad news for applicants with respect to medical underwriting. The bad news is that some carriers are postponing underwriting decisions for individuals who are more likely to be susceptible to COVID-19, such as older buyers, buyers with a medical history, or those who have travelled abroad recently. The good news is that to accommodate the lockdown and the difficulties of collecting medical records from busy doctors' offices, many carriers have adopted accelerated underwriting. Insurance exams are being waived, carriers are accepting digital data from recent physical exams, and electronic signatures are being accepted. Accelerated underwriting is not available in all cases, but for many buyers, particularly healthy buyers of term life insurance, it may be an option. Individuals considering purchasing life insurance should not wait just because they are assuming that medical underwriting has come to a halt. Those considering acquiring permanent insurance may wish to see whether their existing term insurance policy includes a convertibility provision. This provision should permit them to purchase a permanent policy with an equivalent amount of death benefit with no medical underwriting.

In addition to the policy features and benefits themselves, the company underwriting your insurance policy is also a pertinent factor. During the current exceptional circumstances – when companies of all kinds face unprecedented financial pressures – many policy owners may well be asking whether their insurer will definitely be there for them now or at some point in the future. It is worthwhile to review the financial strength of your chosen provider by checking their credit ratings and seeking an assessment of their financial health and experience in prior catastrophic scenarios.

Life insurance is a black box to many. Please do not hesitate to contact your Ropes Wealth advisor if you have questions about your existing policies or are considering purchasing a new policy.

Ropes Wealth Advisors LLC
800 Boylston Street Boston, MA 02199-3600