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No-Lapse Guaranteed UL Disappears

BY ROBERT BLOINK, ESQ., LL.M., WILLIAM H. BYRNES, ESQ.
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It comes as little surprise that life insurance sales have slowed during 2011, according to LIMRA's U.S. Individual Life Insurance Sales report.

The downturn in individual life insurance sales is related in part to the exodus of carriers from the no-lapse UL market, says Ashley Durham, senior analyst, product research at LIMRA. "Part of the slowdown in growth is a reflection of a few companies moving away from lifetime death benefit guarantee universal life (UL) products," she said in a press release.

Universal Life carriers are exiting the lifetime death benefit guarantee UL ("no lapse UL") market in spite of the product's popularity. Sun Life, for instance, exited the market in 2010. Where no-lapse universal life represented 97% of its life business in 2007, today it makes up only 32% of its business. Many carriers that are staying in the no-lapse market are raising their rates, increasing the likelihood of no-lapse's continued decline.

Although sales of no-lapse UL policies have decreased 3% (by annualized premiums) since the second quarter of 2010, the guarantee is still quite popular, with no lapse policies taking 45% of UL market share.

The Downside of No-Lapse Universal Life

The decline of no-lapse guaranteed UL may be a blessing in disguise, because it will force producers to look for other, better options that satisfy their clients' needs for guaranteed benefit life insurance products. The guaranteed death benefit of no-lapse guaranteed UL comes with a price—decreased flexibility to meet the insured's changing financial needs. "No-lapse" varieties of universal life often have a fixed premium—determined by the insured's age and underwriting class.

Ordinary universal life allows insureds to skip premium payments and change their frequency. But with a no-lapse policy, that benefit is generally reduced, since skipping a premium can reduce the length of the guarantee period. And the guarantee period of a no-lapse period is not unlimited; it generally closes after a period of years that may end before the insured's death.

If, after skipping a premium or premiums, the insured then wants to ratchet the guarantee period back up to its previous length, premium payments will need to be increased accordingly.

Another issue with no-lapse UL is that the death benefit guarantee can severely limit the availability of the policy for emergencies or other situations where the insured needs to tap the policy for cash.

The no-lapse guarantee affects the insured's ability to take loans on the policy. The first issue is that most no-lapse UL policies won't accumulate significant policy value, due to the cost of the no-lapse guarantee, thus severely limiting the insured's ability to borrow from the policy. But even where a policy accumulates significant cash value, a policy loan will reduce the guarantee period—in the same way as a skipped premium.

About the Author

Robert Bloink, Esq., LL.M.
Robert Bloink is a professor of tax for the Graduate Program of International Tax and Financial Services, Thomas Jefferson School of Law. Previously, he served as Senior Attorney in the IRS Office of Chief Counsel, Large and Mid-Sized Business Division, where he litigated many cases in the U.S. Tax Court, served as Liaison Counsel for the Offshore Compliance Technical Assistance Program, coordinated examination programs audit teams on the development of issues for large corporate taxpayers, and taught continuing education seminars to Senior Revenue Agents involved in Large Case Exams. In his governmental capacity, Mr. Bloink became recognized as an expert in the taxation of financial structured products and was responsible for the IRS' first FSA addressing variable forward contracts. Mr. Bloink's core competencies led to his involvement in prosecuting some of the biggest corporate tax shelters in the history or our country. Mr. Bloink's insurance practice incorporates sophisticated wealth transfer techniques, as well as counseling institutions in the context of their insurance portfolios and other mortality based exposures.

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