Universal Life Insurance: How it Backfired - Transcript

Tom Mullooly: In Episode 110, we're going to talk about that ticking time bomb called Universal Life.

Welcome to the Mullooly Asset Show. I'm your host, Tom Mullooly, and this is Episode Number 110. Thanks for tuning in.

I want to talk about a Wall Street Journal article that was published recently discussing Universal Life. The headline was: Universal Life 1980s Sensation Has Backfired. And it's backfired in a big way.

The first thing I thought of when I saw the headline was: They still sell these policies? I didn't think they even did that.

Let me explain a little bit if you're not familiar with Universal Life, just give you the back of the envelope explanation of how this works. When interest rates were higher in the 80s and in the 1990s, one of the popular terms, and this actually goes back even further than that, was forget about Whole Life. Just buy Term and invest the rest.

Insurance companies weren't stupid. They found out that, hey, that's really a pretty novel concept, so let's come up with a product that has a 1-year term life insurance policy. It's renewable every year, but it has a savings component, and what we'll do is we'll make the premiums bigger in the front and of course the premiums are going to be more as you get older. So this way the premiums will be level, and the customer will be investing the same amount year in and year out.
So when rates were higher, this was a way for insurance companies to offer insurance, term insurance, with some kind of savings component.

Now what happened was, as interest rates got lower and continued to go to zero, people found out that the interest that was supposed to be paying their premiums wasn't there and now these people who own the policies who bought it in their 30s and 40s and 50s, now they are in their 70s, 80s, and 90s. Do you know how expensive it is to get life insurance at those kind of ages? Don't forget Universal Life is a 1-year term policy.

So the cost to insure their life becomes way, way, way more expensive. So in early years you pay more into this policy than you really ought to and that difference would get siphoned off into some kind of savings vehicle. And it started off as a saving vehicle where you would be guaranteed some kind of rate, or they would project a rate of interest.

Later on, these policies became even more exotic, and they said, forget about the fixed rate, we could put you into mutual funds now, and you can just play the market with this money.

So when agents were giving illustrations to people that they wanted to buy these policies, way back 35 years ago in the 1980s, they would show their projections. They would give them a minimum projection and a normal projection. The minimum projection would be like a 4% rate that they would earn, and then they would show them a projection at 9 or 10% a year. You know, those 9 or 10% years, if you're earning that kind of money, it's going to throw off enough interest to pay the premiums down the road when things start to get really expensive.

So the idea was that the savings component inside Universal Life was going to continue to grow, grow, grow, and then that would help pay the premiums in the future. The problem is when the rates dropped, there wasn't enough interest to cover the premiums and what also happened people they were told, hey, we can skip a payment or two or you could take a loan out against your principal. All these things started to really compound and make a lot of problems for people further down the road.

So the Wall Street article that was ... And we'll have a link to it in the show notes. The Wall Street Journal article talks about how it was widely accepted that not all customers or even all insurance agents fully understood how changing lower rates and borrowing against your policy and skipping out on payments can really wreck these policies and boy did they ever.

So what happened was a lot of people just didn't realize that the rate that they were quoted when they started was not guaranteed for the life of the policy and this was a big oversight. Americans bought on average between two and three million policies a year in the 80 and in the 90s.

Look, the Wall Street Journal article had a couple of examples of people who were still paying premiums they had out, one a 94-year-old woman. 94 years old. She has no need for life insurance.

There was another one, a married couple. This guy's 85-years-old, he's been paying premiums for 30 years. You don't need insurance. Most people don't need insurance at these kind of ages.

So the takeaways, two takeaways from this story with Universal Life. First is, insurance is not an investment. Don't ever, ever, confuse the two. The second thing is, we've said this before on other videos, don't get mixed up in investments and products and schemes that you just don't understand. You're going to lose money. Be really careful. Ask a lot of questions. If you've got policies like this that you don't understand, talk to a financial planner.

That's it for Episode 110. Thanks for watching. See you on the next one.