

Bill Boersma - Blog

Life Insurance Crediting Rates...

Let's talk a moment about life insurance policy crediting rates, where they have been and where they are going. This discussion is regarding whole life dividends and universal life interest rates. It is not about insurance premiums, mortality costs or overhead expenses but rather the underlying investments insurance companies own to back their life insurance portfolios.

For some time now I've been preaching to anyone who will listen that a substantive majority of life insurance policies are underperforming the basis on which they were acquired. This is ascertainable fact based on the knowledge that we are roughly 25 years into a consistently declining interest rate market regarding the investment vehicles which insurance carriers hold to support the policies they have issued over the years.

Put very simply, where were money markets, mortgages and bond rates in the early to mid eighties? Where are they today? If these are basically the money rates that drive life insurance portfolio crediting rates, what is happening to the in-force life insurance which is backed by these rates? The answer; many of these policies aren't doing very well. It's not hard to understand this, once one realizes it is simply cause and effect. What surprises me the most is that there are still those who make the case that their policies haven't been affected by this turn of events. It's preposterous and frankly, it's embarrassing to hear insurance practitioners make these assertions. I'm not sure if this akin to either political or religious dogma but it is disconcerting because it is not doing the policy owners any favors. As with many problems, the first step in recovery and creating solutions is admitting there is a problem.

Universal life policies are down eight hundred basis points or more and traditional whole life

is down five hundred basis points or more from the highs in the eighties. Many of the universal life policies bottomed out at their contractual minimum interest rates in recent years but most whole life policies are still on their way down. In fact, even though the rates may be half of what they were a couple of decades ago, dividend rates for some whole life policies are still substantively higher than the highest point of the entire twentieth century until the run up in the late seventies which is what caused this problem in the first place. Some say we're simply on our way back to historical norms.

Don't keep being surprised and don't underestimate the damage this is doing to existing policies and how it will shape future policies.

Put this all into context relative to a 25 year old and retirement planning. Over the course of a typical 40 year working life, a two hundred basis point drop in investment return would reduce the plan balance by almost half of what was expected! Life insurance policy crediting rates have come down much more than that yet, there is a disconnect in the consumer market that there is a cause and effect and consumers are suffering for it. This is largely because many are stuck in a pre 1970s mindset of how life insurance works. It's a whole new world out there and policy owners need education on what that means for them.

Any insurance practitioners have been absolutely confident that their carrier(s) would not continue to lower rates but it has nothing to do with the quality or intent of the carrier. It is simply financial reality. For years they express surprise that the rates haven't bottomed out but they continue to be shocked year after year.

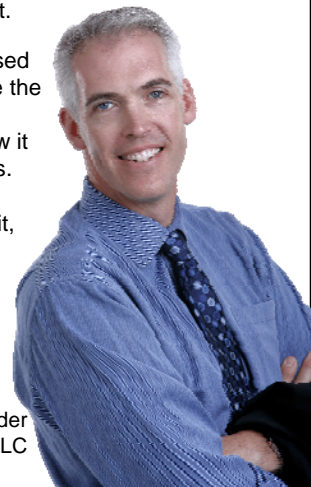
On the other hand, I have been predicting for years, subject to malign intent by some, that these rates will continue their downward trend. Once one understands the fundamentals of the insurance and investment markets and applies basic historical data, it is self evident. No one should be surprised! Looking back a decade or two and being surprised at just how far down things went - Sure. But continually surprised by what is going on - only if you don't understand the rudimentary aspects of the investment and insurance markets.

So... are we at the bottom yet? No. Trust me. At least trust me until I am proven to be wrong because I haven't been yet. What about these policies which are at their minimum crediting rates? Watch out for the internal expenses to start rising as the carriers attempt to make up for it.

Don't keep being surprised and don't underestimate the damage this is doing to existing policies and how it will shape future policies.

If you don't understand it, we need to talk.

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