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Understanding No-Lapse Universal Life

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1. Types of designs: stipulated premium vs. shadow account

2. Advantages over nonguaranteed cash value policies

    a. The guaranteed cost is much lower than the guaranteed cost of traditional cash value policies, and it may even be lower than the nonguaranteed cost.
    b. It requires less due diligence; what you see is what you get.

3. Disadvantages over nonguaranteed cash value policies

    a. You are locking in interest rates and mortality rates for life.

    b. There is usually only one policy design: level death benefit.

    c. Cash values are usually low.

    d. The no-lapse guarantee may not be honored if the issuer becomes insolvent.

    e. The issuer's administrative system may not calculate the values correctly.

4. The great debate: Are insurers cheating on reserves?

    a. Why do reserves matter?

    b. Types of reserves: statutory, GAAP, tax, economic

    c. Reserves, risk-based capital, and asset adequacy analysis

    d. Formula-driven vs. principles-based approaches

        1. Regulation XXX and Actuarial Guideline 38 (AXXX)
        2. Actuarial Opinion and Memorandum Regulation (AOMR)
        3. Risk management methods under development

5. Choosing a no-lapse universal life policy and exploiting the options

Case study #1: Stipulated premium design

Test for no-lapse guarantee: Policy stays in force if the actual premiums accumulated at 3% exceed the required monthly premiums accumulated at 3%.

$380,000 death benefit

$894.90 required monthly premium, payable to age 100

Questions:

Should you prepay the required monthly premiums? (What is the client's opportunity cost of capital? What is the probability of death or lapse?)

What is the required annual premium? (The insurance company's illustration system calculates the required annual premium as 12 times the required monthly premium. So 12 times $894.90 is $10,738.80, but the actual required annual premium is only $10,594.71, because of discounting.)

Case study #2: Shadow account design

Test for no-lapse guarantee: Policy stays in force if the shadow account has a positive balance.

$1,625,000 death benefit

Factors used to compute the shadow account balance each month:

- 12.6% premium load on premiums paid in excess of $109,005 each year during the first 8 years
- monthly cost-of-insurance rate (first year: 1.89 per month per 1000 of net amount at risk)
- net amount at risk
- 7% interest

$185,000 is available from the sale of an existing policy. Initial premium of $54,500 was paid.

Illustrated payment schedules:

- Dump in $185,000 and pay a level annual premium of $84,453
- Dump in $96,096 and pay a level annual premium of $96,096
- Dump in $130,000 and pay a level annual premium of $91,655

Questions:

When should you put the $185,000 life settlement proceeds into the policy?

After putting the $185,000 life settlement proceeds into the policy, should you pay a level annual premium to age 100, or should you pay a higher amount for a shorter period?