

## VUL: Pros And Cons

By Bruce W. Fraser

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When your clients are facing one of the more turbulent markets in recent memory, should you be recommending variable universal life insurance to your clients? For that matter, should you be recommending any variable life policy?

Such policies can fluctuate with market conditions. They invest through subaccounts, which are mirror images of mutual funds. Losses may mean higher or more premiums to pay, or no death benefit, in a worst-case scenario.

If the market performs well, of course, variable life can be a less-expensive way to buy permanent life insurance, particularly for people who need life insurance and want an investment component. But in a prolonged down market, chances are good the variable life product will underperform a traditional life policy.

"It all depends on the underlying choices made by the investor," says Marvin Feldman, president and CEO of the Life and Health Insurance Foundation for Education ([www.life-line.org](http://www.life-line.org)).

Approximately 20 life insurance companies sell nearly 95% of variable premium. Among the top 10 are Hartford Life, Metropolitan Life, John Hancock, Axa Life, Prudential Life and Lincoln National. They account for slightly more than half the market, according to Larry Rybka, CEO of ValMark Securities Inc., an independent broker-dealer in Akron, Ohio.

"There are a smaller number of carriers that sell the product," he notes, "because it requires scale, meaning you have to sell a certain amount of it to be viable for a company to manufacture it."

A little less than 25% of the total permanent insurance market consists of variable life insurance. The first generation of VUL policies in the early 1980s subjected the consumer to the risk that if investment performance did not meet projections, the premium could go up or, if uncorrected, the policy would lapse. Since then, says Rybka, the most innovative companies have created a new generation of hybrid variable policies that incorporate premium and death benefit guarantees.

The investment component of variable universal life resides in the various subaccounts. Life insurance companies typically offer from 40 to 60 different choices, ranging in risk from equities to fixed-income types of investment, to emerging market investments and everything in between. Some companies have their own proprietary subaccounts. Others use a combination of their own and outside accounts to give investors more choice.

"Instead of investing in a general account, it gives the policyholder control over how the additional money is invested to grow that pot of cash," explains Cliff Barron, variable-life line leader at Hartford Life. "The concept is you're going to put money in today and grow that pot of cash for the future."

Assuming that market conditions are benign, the increasing value in these subaccounts—minus the management fees and charges—represents the policy's cash value. "The expenses are similar to those in a traditional life policy," says Feldman. "They include mortality charges, fees, taxes and other operating expenses. The one main additional fee you'll find in a VUL policy is the management fee charged to the individual subaccounts, and that fee will vary based on the type of subaccount, higher for aggressively managed accounts and lower for accounts that require less management."

According to Hartford Life, such insurance is most appropriate for those investors with a higher risk tolerance, those who are comfortable investing in equities and in search of other tax-favored means of investing besides a 401(k) or IRA. It's suitable as well for investors who have a death benefit need for their beneficiaries, and also a good fit for more affluent investors with estate planning needs, who may wish to pass their wealth on to their beneficiaries.

One of the knocks against the earlier-generation VUL products is that they involve a combination of investments and insurance. "Combining investments and insurance is like combining oil and water," says Aaron Skloff, CEO of Skloff Financial Group, a wealth management firm in Berkeley Heights, N.J. "They generally result in a bad combination. Too often the investment choices are limited or, even worse, exclude key aspects of a properly diversified portfolio. Many times the investments are limited to the inferior proprietary subaccounts from the insurance company's lineup."

Skloff also criticizes the way such policies are sometimes sold. "Many insurance agents illustrate double-digit rates of return within the policies, an unreasonable expectation for most policyholders. It was these aggressive expectations in the mid-late 1990s that led many VUL policyholders to believe they could discontinue their payment premiums early. An unusually strong investment performance in the late 1990s reverted back to the mean, and in the following decade many VUL policies imploded."

Feldman says such criticism may be partly accurate but not totally so. Most companies, he says, may have proprietary products, but they usually include a mix of other subaccounts representing different types of families of funds.

John Resnick, an estate planner at Resnick & Associates in Harrisburg, Pa., and host of a syndicated radio show on business moguls called Legends of Success, criticizes the cost of VUL policies. He feels mortality and expense (M & E) charges, which he says are often buried within the fine print, are too high.

"One thing that is certain," says Resnick, "is that mortality costs with the policy are guaranteed to increase as the insured gets older. One thing that is uncertain is the performance of the side investment funds. So if you combine increased mortality charges with a less-than-expected rate of return on the investment, the policy can implode and lapse without value."

Rybka disagrees with this assessment and counters: "None of the expenses are disclosed in a traditional product, whereas with a variable product, the SEC requires a prospectus and an accounting to the penny in a detailed confirmation state for each premium."

In Resnick's opinion, term life insurance is a better deal for investors under certain circumstances than VUL because it is less expensive. "The reason it is so inexpensive is not because Santa Claus is at the helm of the insurance company," he says, "but if you hold onto the term policy for the long run, it will either cancel itself out or the premiums become unaffordable as the insured gets older. The only day you'll see the term insurance or the mortality charges of VUL not increase is the day that younger people start dying faster than older people."

Daniel B. Roe, chief investment officer of Budros Ruhlin Roe, a wealth management firm in Columbus, Ohio, also feels term insurance is "the most appropriate solution for assuring liquidity upon one's death. Only those that sell life insurance try to make it more complex to fabricate the 'need' for VUL. Any other use simply allocates capital to a less optimal environment due to the greater expenses of investments within a VUL policy, as well as the conversion of potential capital gains to ordinary income."

Feldman says, "It all boils down to the needs of the client and determining the best solution given the client's problems to be solved."

Guy Cumbie, a planner in Fort Worth, Texas, and a past president of the Financial Planning Association, does not object to VUL insurance as a product nor does he object to its higher expenses, but he says investors have to exercise caution because of its complexity.

"The no-load, low-load guys that are supposed to wear the white hats in the insurance world, at least in the eyes of the planning community, have a product," Cumbie says. "It's not necessarily a disastrously expensive product, it's just complex and therefore subject to abuse, but there's nothing inherently bad about it."

"The more there is a definitive need at the death for a specific death benefit, the more caution you need to exercise utilizing that kind of product."

Rybka believes many of the criticisms against VUL are unjustified. He says the newer variable universal products address many of the concerns advisors and investors have about costs and risk in VUL. He points out that in the newer products, "your premium and death benefit are guaranteed, so it doesn't matter if the cash value fluctuates."

Further, he maintains: "The advantage of an equity-based cash value creates a compelling case for many clients. All insurance companies are financial intermediaries. They buy financial instruments like mortgages, bonds and equities and repackage them to provide benefits for the consumer like death benefits. With universal variable life, the consumer can have the compounding power of equities working for him."

Not all these policies are created equal, of course. As you would investigate any product, you have to be a good shopper and look under the hood. Determine how the products have performed over time. Make sure you look at the underlying subaccounts, and ascertain whether there are a good number of choices across the style box. Your clients' needs may change as they get closer to their retirement goals, and they may want to reallocate their investment choices.

Says Feldman: "It really comes back to what the client needs, and then the advisor should recommend the product most appropriate for that situation. The advisor, whether insurance or financial, needs to keep the needs of the client in the forefront." □

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