Exploring the Benefits of Whole Life Paid-Up Additions

Purchasing the largest amount of permanent fixed level death benefit for the least amount of money may be a prudent move in the short-run, but is it the right design for every scenario? Policies with a fixed level death benefit such as guaranteed universal life have two potential problems. First, the value of future dollars is likely less than the value of current dollars. Inflation has been persistently present in the United States for decades, and its continuation at historic rates would mean that the future purchasing power of the death benefit will be substantially less than it is today. Everyone has heard stories about how stores many years ago used to sell bottles of soda for a nickel – a laughable notion today considering the current value of a nickel. But the same logic works for life insurance. A million dollars today may have much higher purchasing power than a million dollars in 50 years.

The second potential problem with such a fixed level death benefit policy is client longevity. Living a long time allows even low rates of inflation to significantly reduce the purchasing power of a level death benefit. Longevity also opens the client up to the possibility of living through periods of dramatically different inflation rates from the historical average. But more importantly, a fixed level death benefit policy will naturally deliver lower rates of return on the death benefit at later years if premiums are required to keep the policy in force annually until maturity, as is commonly illustrated. Think of it this way – every premium payment paid into a product reduces its rate of return on the death benefit if it remains constant. Therefore, living a long time means more premium payments and lower rates of return. Although the short–term returns on fixed level death benefit policies with lifetime premium requirements such as guaranteed universal life can be quite favorable, the long-term returns can fall below the rate of inflation and potentially even become negative if the client lives long enough.

While there’s no denying that these fixed level death benefit policies may offer the best way to buy as much permanent death benefit as possible today at the most affordable price, it may not be the best way to position life insurance for long-term success within some financial plans. So ask yourself two questions about the future – do you think mortality is going to continue to improve and do you think the current rate of inflation will continue or even increase? If you answer “yes” to either of those questions, alternatives to these traditional fixed level death benefit designs might be worth exploring as a part of a life insurance portfolio. Mortality improvements mean that more and more people will live long enough to potentially see the value of their fixed level death benefit policies chipped away by inflation and ongoing premium payments.

One alternative is a Whole Life policy. While a Whole Life contract has a base guaranteed level death benefit, many such policies are also eligible to receive dividends which, while not guaranteed, to the extent they are paid can be used to offer a distinctly different death benefit profile by purchasing paid-up additions (PUA) to the death benefit coverage. Each paid-up addition acts like a single premium Whole Life product such that the death benefit would grow over time if dividends continue to be paid on both the base policy and the paid-up additions. The tradeoff for receiving an increasing death benefit is that the early death benefit is less than what the client would be able to purchase in a lower premium fixed level death benefit policy. The chart below compares a MetLife Promise Whole Life policy using the current, non-guaranteed dividend schedule to purchase paid-up additions against a survey of eleven fixed level death benefit Guaranteed UL policies that MetLife conducted in March 2016.

Based on the current non-guaranteed scale with illustrated dividends purchasing paid-up additions, the Whole Life death benefit will exceed the death benefit of the average Guaranteed UL product at the client’s attained age 83 and the most competitive Guaranteed UL product at the client’s attained age 89. Prior to that point, the Whole
Life policy can deliver as little as half of the death benefit of the Guaranteed UL product. But after the illustrated crossover point, the Whole Life policy continues to grow and based on the current non-guaranteed dividend scale delivers nearly twice as much death benefit as the average Guaranteed UL product by age 100. For clients aged 55 and 65, the illustrated crossover point between the average Guaranteed UL product and the Whole Life product is attained age 89 and 92, respectively.

So what’s the right fit for your client? Clients concerned about living beyond the crossover point should seriously consider purchasing Whole Life as a part of their overall life insurance portfolio assuming that their need for insurance is not expected to diminish in the future. But let’s go back to the two questions we posed earlier about future mortality expectations and interest rates. Much in the same way that a dollar today isn’t comparable to a dollar 50 years ago, mortality expectations have consistently improved over time and are expected to do so in the future as well. Improving mortality means that more and more clients will likely live beyond their illustrated crossover point – allowing them to experience the better long-term performance potential offered by dividend eligible Whole Life policies. It is important to note that dividends are not guaranteed and that mortality, interest rates and expenses are subject to change. Actual results will vary and are dependent on the client’s individual situation and could be lower than illustrated.

Ultimately, any decision about life insurance should involve more factors than just price for today’s death benefit. While keeping in mind that future results may be more or less favorable than currently illustrated, paying more today to potentially receive more at a later date, as with Whole Life paid up additions, may be a more advantageous choice for some clients looking to hedge both longevity and inflation risk in their life insurance portfolio.
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