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The Concept

- Universal life insurance combines permanent life insurance protection with flexible product features such as adjustable premium arrangements, flexible death benefits, and the potential for faster cash value growth.
- Unlike other types of cash value life insurance, poor policy performance (through loans, withdrawals or underfunding) can cause the policy to lapse. Therefore, policyowners need to manage universal life insurance responsibly to keep the coverage in place.

The Premium

- Universal life differs from traditional life insurance in that a policyowner may increase or decrease premium payments—or skip premiums completely in particular years—as finances or priorities change.
- After the policy has built up sufficient cash value, a policyowner may reduce the premium or skip it entirely. There is no limit to how often or to what extent the policyowner may reduce or skip premiums, as long as the cash value is sufficient to keep the policy in force.
- Reducing or skipping premiums will reduce the cash value and the death benefit; however, this allows a policyowner experiencing financial hardship to maintain needed insurance coverage in difficult financial circumstances.
- A policyowner who reduces or skips premiums should remain vigilant, since this can deplete the cash value and put the policy in danger of lapsing. If this situation occurs, the insurance company is required to notify the policyowner and advise the minimum premium required to keep the insurance protection in force.
- Some policyholders choose to pay higher premiums than required to maintain the insurance protection as a way of building cash value.
- A policyowner who pays higher premiums should remain vigilant to maintain a specified amount of “pure insurance” protection that is not attributable to the cash value element or risk losing the tax-favored status life insurance enjoys.

The Death Benefit

- The owner of a universal life insurance policy can also adjust the death benefit.
- A policyowner who decides that the original amount of insurance isn't enough can increase the death benefit with the insurance company's approval. The company will consider insurability when deciding whether to approve a higher death benefit.

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- If the death benefit increases, the minimum premium will also increase.
- The policyowner retains the flexibility to pay additional amounts into the cash value and to decrease or skip payments when there is enough cash value to support the policy.

The Options

- With universal life coverage, the policyowner chooses from two death benefit options—a level death benefit and an increasing death benefit.
- Option A (or Option 1) is a level death benefit equal to the face amount of the policy. With this option, the cash value is a part of the death benefit instead of a separate, additional amount. This is identical to the death benefit in a traditional whole life policy.
- With Option A, the policyowner can still reduce the death benefit or request an increase. But since the pure insurance protection requirement must be maintained for the policy to retain its tax-favored status, the insurance amount may have to be increased if the cash value approaches the face amount.
- Option B (or Option 2) offers an increasing death benefit consisting of the policy's face amount plus the accumulated cash value.
- With Option B, the pure insurance protection amount remains the same throughout the life of the policy. The growing cash value is what accounts for the increasing death benefit.
- Thus, with Option B, the exact death benefit isn't known until the insured dies and the accumulated cash value is added to the face amount.
- Option B requires a higher premium since the pure insurance protection is never reduced by the increasing cash value, as it is with Option A.
- Some insurance companies also offer an Option C, where the death benefit is the face amount of the policy plus aggregate premiums paid, less any cash value distributions.

Changing Options

- Universal life insurance policies permit the insured to request a change from the death benefit option that was first selected.
- Changing from Option A to Option B may require proof of continued insurability since it involves a greater amount of insurance—and therefore a greater risk for the insurance company.

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- Changing from Option B to Option A has no such requirement because, like conventional permanent insurance, the pure insurance amount decreases as the cash value increases, combining to equal the policy's face amount.

Other Features

- While a universal life policy guarantees a minimum interest rate relating to cash value growth, it typically pays a current rate that is higher than the minimum amount. Paying a higher rate potentially helps the cash value account grow more rapidly.
- All guarantees are based on the claims-paying ability of the insurance company.
- Policyowners periodically receive a statement showing the various charges assessed in a universal life policy, as well as the current cash value amount.
- Premium expense charges are deducted from premiums paid, with the net premiums added to the cash value.
- A monthly charge for the pure insurance protection and a monthly administrative fee are both deducted from the cash value.
- The insurer assesses a surrender charge when a policyowner terminates the policy within the surrender-charge period (usually 3–15 years from issue). The charge is usually higher in the policy's early years, gradually decreasing the longer the policy stays in force.

Policy Loans

- Like traditional life insurance, universal life policies permit policy loans when the cash value is sufficient. The policyowner is charged interest on the loan, often at a lower rate than is available with a conventional loan.
- A universal life policyowner may also take a partial surrender of the cash value instead of a loan. Although no interest is charged, the partial surrender may be subject to current income taxation and will reduce the policy's cash value and death benefit.

The Bottom Line

The appeal of universal life insurance is its flexibility. A universal life policyowner isn't locked into an unchangeable premium or death benefit, but can adjust both to keep up with changing needs and circumstances.

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SUMMARY

What Is Universal Life Insurance?

Universal life insurance, while similar to traditional cash value contracts, includes variations and options designed to make life insurance more attractive to consumers. A major difference is that universal life policyowners can adjust both the premium and the death benefit—up or down—throughout the insured's life.

How Do Flexible Premiums Work?

The insurer initially establishes a minimum premium required to keep the insurance in force.

The policyowner may then choose to pay a higher premium, with the excess over what is needed for the insurance protection going into the cash value account, where it can accumulate for the policyowner's benefit. Universal life policies may pay higher rates of interest on the cash value than the minimum interest guaranteed in the contract.

When there is sufficient cash value to pay the cost of the insurance protection, the owner may choose to reduce the premium or skip it entirely.

How Does the Flexible Death Benefit Work?

Policyowners may choose from two death benefit options when the policy is put into effect, and may increase or decrease the amount during the policy period.

Option A provides a level death benefit similar to traditional permanent insurance, where the pure insurance protection decreases as the cash value increases.

Option B provides a death benefit that increases over time because the cash value is added to the selected life insurance benefit. As the cash value increases, so does the death benefit.

With the insurer's approval, the policyowner may change from Option A to Option B and vice versa. A certain amount of pure insurance protection must always be maintained.

Some insurance companies also offer an Option C, where the death benefit is the face amount of the policy plus aggregate premiums paid, less any cash value distributions.

How Does the Policyowner Keep Track?

Policyowners periodically receive statements that show the various charges assessed in a universal life policy, as well as the current cash value. Some examples:

- Premium expense charges are deducted from premiums paid, with the net premiums added to the cash value.

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- A monthly charge for the pure insurance protection and a monthly administrative fee are deducted from the cash value.
- A portion of the cash value secures the cost of any surrender charges if the policy is cashed in. The cash value balance, less any outstanding loans and accrued loan interest, is accessible to the policyowner through loans or partial surrenders.

What Are the Benefits?

Universal life insurance offers the potential for faster cash value growth. When the cash value is sufficient, the policyowner can then withdraw policy loans or partial surrenders from the cash value account.

The policy features flexibility in the amount and frequency of premium payments, plus flexibility in selecting and changing the amount of the death benefit. The insurer keeps the policyowner current with any changes through periodic statements.

Clearly, universal life's appeal lies in its flexibility. The universal life policyowner isn't locked into an unchangeable premium or death benefit, but can adjust both to keep up with changing needs and circumstances throughout life.

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