Your Money Matters

New Life Insurance Policies Are Better Deal; They Offer Decent Returns Besides Protection

By JILL BETTNER
Staff Reporter of THE WALL STREET JOURNAL

Where can you get one of the highest tax-deferred—or tax-free—yields on your savings? Try life insurance.

Yes, life insurance. An entirely new breed of whole-life products, currently offering yields of more than 10%, is finally bringing traditional life insurance that incorporates a savings feature into the 1980s. In fact, they could be some of the best tax shelters around.

Whole life, as opposed to term insurance, which offers strictly protection, has always been a tax shelter of sorts. Returns on the cash you put into a whole-life policy accumulate tax free. And a policy can be structured so that the death benefits can go to a beneficiary who escapes having to pay income and estate taxes on the proceeds.

"It's just that the insurance companies are currently earning more on their own investments, and they're willing to pass more of those earnings on to the policyholder," says Dennis Van Mieghem, national tax practice director for insurance at the accounting firm of Peat, Marwick, Mitchell & Co. in Chicago.

The companies that sell whole-life needed more than a gentle nudge to become more generous. It was either give the policyholder a better return, or watch the product itself die.

As interest rates have risen, policyholders and individuals who were once potential buyers have abandoned whole life in droves. Millions of them have opted for lower-cost term insurance, preferring to put the difference in premium payments into, say, money-market funds or savings certificates offered by banks.

In addition, hidden expense charges or "loads" that are levied against insurance-savings dollars, particularly in the early years of an orthodox whole-life policy, have come under increasing attack by consumer groups.

Sorting Out What's New

The policies with the attention-grabbing yields are among a slew of whole-life products being put on the market in an effort to lure savers back into the fold.

Some of the policies that have been introduced recently with big advertising campaigns have gimcracks and gewgaws that don't significantly affect the rate credited to savings, insurance-industry experts say. Such features include optional riders to purchase—at an additional cost over the basic premium—one-year, renewable term insurance that increases in proportion to any rise in the Consumer Price Index.

Products that truly advance the state of the art fall into two main categories. While individual policies sold by different companies have gimmicky marketing names like "The Challenger" and "Directed Life," these products are best-known within the industry by the generic names "universal life" and "variable life."

And they are real breakthroughs for consumers. These policies offer the opportunity for respectable returns on your investment, compared with orthodox whole-life products (see accompanying table). Also, the policies reveal, for the first time, exactly what you get for every dollar you put in.

Essentially, these policies combine the savings feature of whole life with the pure protection of term insurance. More importantly, though, they pay an interest rate on the savings (the cash value buildup) that is designed to remain competitive with the current and future rates available on popular financial instruments, including money-market funds and Treasury bills.

Here's how the two new types of high-yield policies work and how they differ in some important respects to orthodox, whole-life policies that pay dividends (participating) and those that don't (non-participating).

UNIVERSAL LIFE. Widely considered to be the "wave of the future," this kind of policy is currently offered by only a handful of stock companies. But it is being studied by hundreds of other companies, including the mutual giant Prudential Insurance Co.

For corporate-insurance tax reasons, universal life can more easily be offered by stock companies than by mutual companies. The speculation is that mutual companies will soon begin selling the policies through stock-company subsidiaries they either already own or plan to acquire or through brokerage houses. Prudential announced several weeks ago that it plans to acquire the Bache Group Inc.

Policies currently on the market include "The Economist," sold by First Penn-Pacific Life Insurance Co., "The Challenger," from Life Insurance Co. of Virginia, "Completelife," from E.F. Hutton Life Insurance Co., "T-Plan Life," from Transamerica Assurance Co. and "Ultimate Life," from Occidental Life of North Carolina. Because of varying insurance laws, the policies aren't available in all states.

Unlike orthodox whole-life policies, which typically offer a fixed amount of protection at a fixed premium, universal life lets you change the face amount of the policy and pay premiums of as much as you like when you want to pay them. The policies usually show a payment schedule, but skipping a premium doesn't cause the policy to lapse. (For purposes of comparision only, the accompanying table uses a fixed premium of $2,000.)

A Choice of Plans

The death benefit is figured two ways, depending on how much of your premiums you want to go into the cash buildup. If you opt for minimal insurance, the death benefit is equal to the specified face amount of the policy you say you want to maintain. The coverage is kept at that level with monthly deductions from your cash value to cover the cost of the pure insurance. Some policies are being offered in minimum face amounts of $100,000; others have minimums of as little as $25,000.

As long as you maintain a "corridor" between the amount of death benefits and the accumulated cash value, you can put as much of your premiums into tax-free savings as you like. The corridor, typically $25,000 or 10% of the accumulated cash value, is intended to keep these policies life-insurance products; at least, the companies say they are hoping it will. If the cash value gets too close to the amount of death benefits, the company simply deducts part of the cash value to pay for more term insurance.

But, say you are more interested in accumulating both insurance and the maximum in tax-free or tax-deferred savings. You can make partial withdrawals of the cash value later without paying loan charges. You can take most of the money out tax-free—up to the total premiums paid—to use the money for, say, college expenses.

Under the second option, the death benefit is equal to the face amount of the policy plus the cash-surrender value. In both cases, the cash-surrender value includes total premiums paid at a guaranteed interest rate (usually 4%), plus additional interest determined by the company.

For instance, the additional interest offered by The Challenger is pegged to the return on a 20-year bond fund, which is managed in a separate account by the company. The fund is currently yielding 10.88%. T-Plan Life promises to match the rate on 91-day Treasury bills, which fluctuates weekly. The guaranteed rate on T-Plan Life, however, is 3% rather than 4%.

The companies' expenses (or the load) are typically equal to about 7% to 10% of each premium payment. There are also monthly deductions for the cost of pure protection. There may also be a first-year charge, which varies widely. On Completelife, it is $252; on The Challenger, it is $600. T-Plan Life has no first-year charge. All three policies, and possibly others, detail all charges in an "annual report" to policyholders.