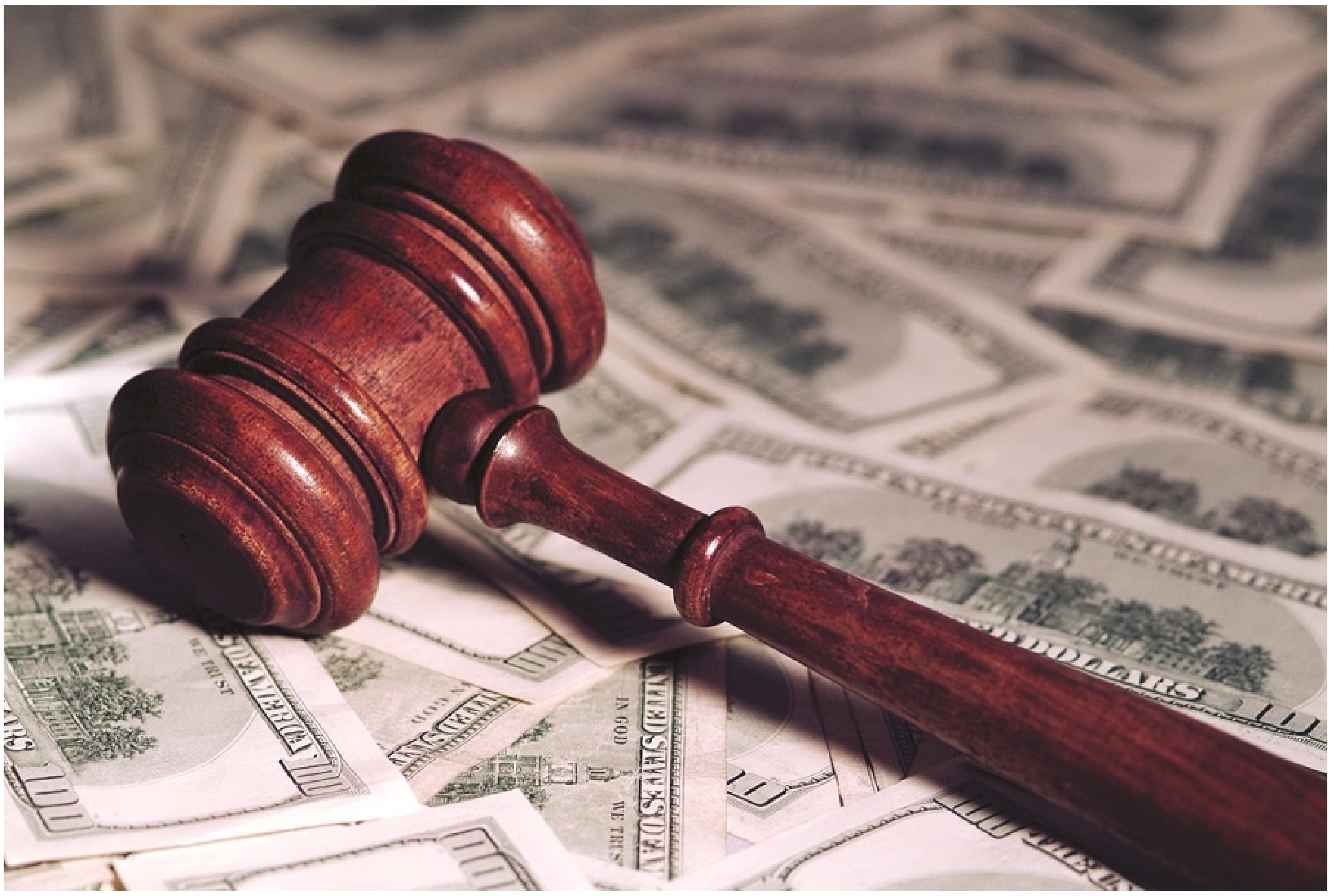
FEATURES Insurance

Universal life insurance lawsuits underscore product risk

Sudden cost increases could cause clients to pay much higher annual premiums — or lapse their policies.



September 19, 2018 *By Greg Iacurci*

Lawsuits filed against insurers in recent years for their practices around universal life insurance policies highlight the risks these products can pose to unwary financial advisers and clients.

Transamerica Life Insurance Co., AXA Equitable Life Insurance Co. and Lincoln National Corp. are examples of firms currently in the crossfire of litigation for ***raising the cost of insurance in certain universal life policies***.

Nationwide Life Insurance Co. also privately settled a lawsuit with two individuals in May relative to variable universal life insurance costs. John Hancock Life Insurance Co. settled a lawsuit related to UL insurance costs in July for $91.25 million.

Unlike other products, such as term and whole life, universal life — which is permanent, cash-value life insurance — allows buyers to make flexible premium payments. That flexibility allows buyers to fund policies with a relatively low amount of premiums to keep the insurance going. However, a cost increase could leave these clients with an unattractive choice: pay a much higher annual bill to keep the contract afloat or lapse the policy altogether.

"They don't know what they can do," said James Hunt, the Consumer Federation of America's life insurance actuary. "They paid a premium and they thought they paid for life, and are now facing extremely high premiums to keep them going."

(More: *State fiduciary rules may be reckoning for life insurance industry*)

The recent wave of lawsuits, which began cropping up around 2015, have targeted UL policies sold in the 1980s and 1990s, experts said. Insurers offered an attractive guaranteed minimum interest rate to policyholders of about 4%-5%, experts said, supported by higher interest rates set by the federal government during this period.

While UL policies contractually allow insurers to adjust insurance costs up to a maximum rate based on certain factors, plaintiffs broadly claim that insurers raised costs to make up for bad bets on interest rates. Insurers claim the increases are warranted, due to things such as mortality conditions that increase the frequency of claims they have to pay.

The Consumer Federation of America sent a letter to all state insurance commissioners in 2016, saying that many UL policies "are failing or will soon begin to fail absent much higher interest rates."

The cost increases relevant to the recent class-action lawsuits extended into the double and triple digits on a percentage basis.

"It's in bad faith," Joseph Gentile, partner at Sarraf Gentile who represents plaintiffs in the Lincoln National case, said of the increases. "It's not really tied to mortality, it's tied to the change in the interest rate environment. The actuaries priced things wrong way back when."

Hank Williams, spokesman for Transamerica, and Lincoln spokesman Jay Russo said it's against their respective companies' policies to comment on pending litigation. A spokesperson for AXA didn't return a request for comment.

(More: *States try to beat back rate increases on long-term-care policies*)

The John Hancock lawsuit is a bit different from the other cases. Plaintiffs in this case — 37 Besen Parkway, LLC v. John Hancock Life Insurance Co. — allege the company failed to decrease its cost of insurance as mortality rates decreased.

As experts point out, clients and advisers should go into a UL sale understanding the risks.

"Since the financial crisis, a lot of brokers and agents have been caught with their pants down," said Gregory Olsen, partner at Lenox Advisors Inc. "If you haven't learned your lesson that fees and expenses in a universal life or variable universal life policy can skyrocket, and you should do things to [counter] that, then your head's in the sand."

With universal life, that means understanding that a contract could go "sideways" if insurers credit the minimum interest rate to a policy and impose the highest contractual cost of insurance, Mr. Gentile said. It would be wise to fund a policy as if these events had occurred, he said.

(More: *Life insurance helps with retirement planning, but beware of the pitfalls*)