“ALL PROGRESS BEGINS WITH TELLING THE TRUTH”

(Yes, the gravitational pull of low interest rates impacts whole life polices too!)

Lawrence J. Rybka, JD, CFP® and Thomas R. Love, CLU, FLMI

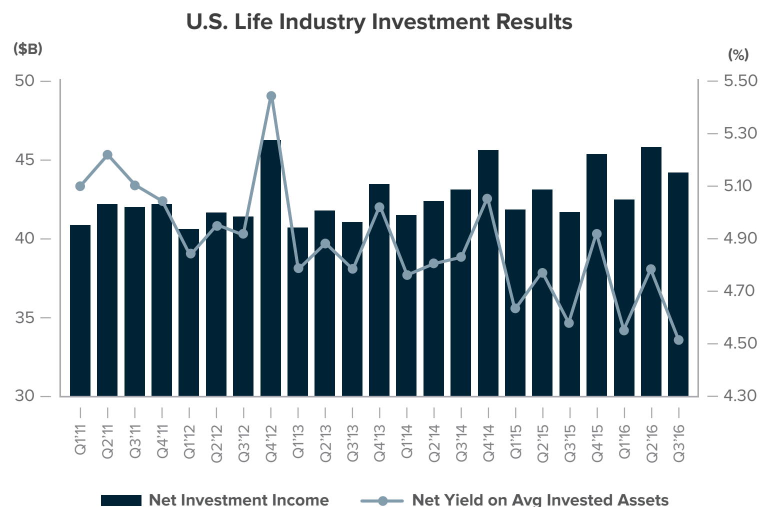
CAUTION! BEWARE OF LOW BOND YIELDS.

This quote by Dan Sullivan from Strategic Coach applies to so many areas of life, including life insurance. But when it comes to life insurance products, U.S. life insurance companies are slow to acknowledge the impact that a 3% bond has on general account products and the impact it will have on life insurance premiums that clients pay. Low interest rates continue to challenge the U.S. life insurance industry as evidenced by actions taken by several U.S. insurance carriers over the last few months. Changes that have been made by both mutual carriers and stock carriers are a sign that no product type or carrier structure is immune from today’s economic realities.

Several carriers implemented price increases for newly purchased policies featuring death benefit guarantees while a few carriers placed limits on the maximum face amount that could be issued on certain new policies. There have also been several news articles written about life insurance carriers raising non-guaranteed expenses on existing policies. These articles have largely focused on the actions taken by stock insurance companies rather than mutual insurers. The changes are undoubtedly influenced, to a large degree, by the pervasive low interest rate environment.

Mutual life insurance companies primarily sell a form of life insurance called “whole life”. Whole life is the oldest form of life insurance, originally created in the mid-1800’s, that charges clients a high premium and then refunds a portion of the premium through dividends. Dividends, which are not guaranteed, are a substantial part of the projected policy benefits. These products are impacted by low interest rates just as much as products from any other life insurance company. However, the projected dividend scales are just starting to show the impact. If one were to listen to some of their agents’ recent sales pitches for whole life, one would believe that these companies exist in an alternate financial universe where they can turn 3% bonds into 6% gold though some form of financial alchemy. Some of these agents position whole life products as a way for clients to avoid today’s low interest rates.

This promise is based on the false premise that an insurance company’s projected dividend rate can float above today’s low yields indefinitely with illustrations that project the rate being compounded over decades. As reported for the 3rd quarter of 2016 (see chart below), the net yield on average invested assets for the life insurance industry was 4.51%. All four of the major mutuals (Northwestern 4.00%, Mass Mutual 4.16%, Guardian 4.62% and New York Life 4.18%) are inside the expected range for investing in similar assets.[1] The portfolio rate on which most whole life dividend scales are based is higher than the yield



on today's bonds and a corresponding crediting rate on most general account universal life products. That is because the rate represents the yield on all existing assets, including bonds and mortgages, which were acquired when rates were higher. But these rates are coming down, and must keep doing so, as new money is invested, existing bonds roll over, and as interest from existing bonds gets reinvested at today's yield.

Carrier	Estimated 2017 Dividend Payout	Approximate Change from 2016 Dividend Payout	2017 Dividend Interest Rate	Change from 2016 Dividend Interest Rate
MassMutual	$1.6 Billion	-$100 Million	6.70%	-0.40%
New York Life	$1.77 Billion	+$70 Million	6.20%	No Change
Northwestern Mutual	$5.2 Billion	-$400 Million	5.00%*	-0.45%
Guardian	$847 Million	+$11 Million	5.85%	-0.20%

* *Also announced an increase in some expense charges in dividend calculation. In addition, comparable expense increases will be made to universal life and variable universal life policies.*[4]

In the last few months of every year, the mutual life insurance companies announce their policyholder dividend scale actions for the upcoming year. The dividend is essentially a rebate or return to policyholders of monies earned through favorable experiences the company has had above very conservative guarantees that are in whole life policies. Excess interest returns above a 3% guarantee has traditionally been the biggest component of the dividend, with mortality and expenses being lesser components. The press of low interest rates has taken its toll with dividend interest rates dropping an average of 19% with the four largest mutual life companies in the last 10 years.[2] The announcements this year have been a sobering reminder that mutual carriers are not immune to the realities of the economy at large and the primary asset held by life insurance carriers: bonds. The table above indicates information from the recent 2017 carrier dividend announcements impacting participating whole life policies.[3]

Consideration of only the dollar amount of the policyholder dividends paid by the carriers can give the perception of continued increases or minor declines. Although 2016 statutory financials won't be released until early 2017, an analysis of 10 years of carrier statutory financial filings from 2006-2015 in the charts below casts a different light on dividends paid out to policyholders.[5] When measuring the dollar amount of the dividends paid as a percentage of a carrier's capital and surplus, it appears that carriers are actually paying out materially less in dividends, despite seemingly high dividend interest rates.

Are actions that result in reduced policyholder dividends indicative a carrier is cheating policyholders or is in dire financial straits? No, but they do illustrate simple economic realities of all financial intermediaries manifesting at the mutual carriers, just as they have in other ways with stock carriers. The majority of investments that are owned by life insurance companies are concentrated in high quality bonds[6], making these companies naturally susceptible to the effects of prolonged low interest rates. According to Northwestern Mutual's Chief Investment Officer, the company generated $6 billion less in income than it would have in a normal interest rate environment.[7] These kinds of earnings reductions (which have been impacting carriers for years now) simply cannot be ignored indefinitely. Prudent carriers must recognize and adapt to these economic realities in order to maintain their financial strength.

Policyholder Dividends (in $000s)	Northwestern Mutual	Mass Mutual	Guardian	New York Life
2006	$4,625,708	$1,226,454	$619,178	$1,545,575
2015	$5,609,398	$1,727,594	$826,080	$1,923,250
10 Year Change	21%	41%	33%	24%

Capital & Surplus ($000s)	Northwestern Mutual	Mass Mutual	Guardian	New York Life
2006	$11,684,376	$7,026,842	$3,490,207	$11,300,273
2015	$19,659,624	$14,982,532	$6,089,670	$19,495,935
10 Year Change	68%	113%	74%	73%

Policyholder Dividends / Capital & Surplus	Northwestern Mutual	Mass Mutual	Guardian	New York Life
2006	39.6%	17.5%	17.7%	13.7%
2015	28.5%	11.5%	13.6%	9.9%
10 Year Change	-28%	-34%	-24%	-28%

Whole life remains a viable choice for funding long-term life insurance plans, provided the client understands the limitations of the product and the impact of lower rates on their policy. In the dividend reduction notice, Northwestern Mutual suggested that all illustrations showing the 5% current dividend interest rate also be accompanied by an illustration showing an alternative dividend scale of 4%.[8] This admission of economic reality should be applauded and stands in contrast to some companies that let their agents create unrealistic expectations for policyholders, based on economics which have little probability of occurring. Carrier adaptations to the economic climate sometimes manifests in diminished policy values, reduced dividends, higher expenses, or higher out-of-pocket premiums for policyholders. It is imperative that policyholders work with knowledgeable insurance advisors who recognize and can adapt to the effects these changes may have in order to appropriately set expectations on the impact to policies. ■

ABOUT THE AUTHORS

Lawrence J. Rybka, JD, CFP®

Lawrence J. Rybka is President and Chief Executive Officer of ValMark Financial Group, which includes a broker dealer, an investment advisor and Executive Insurance Agency (the nation's first producer group). ValMark serves 120 premier independently-owned and run wealth management/transfer firms in 31 states. Over the last 29 years, Larry has authored over a dozen articles in U.S. financial industry journals about the future of financial advice. Two of his articles were recognized with industry awards: the Journal of the American Society of CLU and ChFC's Author Award as well as the CFP Board's Article Award. He is also co-author of one of the CCH Tools and Techniques Books with Steven Leimberg. Larry's industry leadership also includes terms on the Boards of AALU and the MDRT Foundation. He has also served as the Chair for various committees in the industry, including twice as the AALU Chair of the Regulatory Reform Committee and CFP Board of Examiners.

Tom Love, CLU, FLMI

Tom Love is the Vice President of Insurance Analytics for ValMark Financial Group. In his role, he is responsible for advanced life insurance case design, carrier and product analysis, product sales and marketing, development of analytical and educational tools, agent training and agency business development. Mr. Love has over 25 years of experience in the life insurance space spanning a wide range of roles including home office experience, agency experience, and personal production. In addition to earning a Bachelor's degree in Risk Management & Insurance, he currently holds the FINRA Series 6 and 63 securities licenses and life, health and variable licenses.

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[1] Source: SNL Financial data.
[2] Source: Analysis of historical carrier dividend interest rate announcements.
[3] Source: Carrier 2016 and 2017 dividend announcements and Frequently Asked Questions.
[4] Source: ITM/Twenty First
[5] Source: SNL Financial data.
[6] Source: SNL Financial data.
[7] Source: ITM/Twenty First
[8] Source: ITM/Twenty First

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