

Life Insurance: Variable Universal-Life Insurance

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Overview

For many years, the investment options for cash-value life insurance were limited to the general accounts of the insurance companies. See *Life Insurance: Whole-Life Insurance*, Virginia Cooperative Extension publication 354-145, and *Life Insurance: Universal-Life Insurance*, Virginia Cooperative Extension publication 354-146, for more information on **cash value** and how excess **premium** dollars are invested. Variable life insurance can be either whole-life insurance or universal-life insurance. However, not many agents sell variable whole-life, therefore, this publication only discusses variable universal-life insurance. All of the options available in fixed universal-life insurance are available in variable universal-life insurance. The differences will be discussed below.

The term “variable” simply refers to “different investment options.” Variable universal-life insurance allows the policy **owner** to choose how the cash value is invested. Some variable policies have up to 50 different “sub-accounts” from which to choose. These sub-accounts are similar to mutual funds, but have different expenses.

The Cash-Value Account

The cash-value account of a policy is similar to a savings account within the policy. After the insurance company takes the amount of money it needs from the premium payment to meet the cost of term insurance, the extra dollars go into the policy’s cash-value account. This cash value can then be used to help meet the costs of the term insurance in later years, when they can get very high.

The returns on the cash-value account are income tax free. When the owner uses the growth in the cash-value

account to pay insurance costs, he or she is paying for the insurance with before-tax dollars. Premium payments are after-tax dollars (i.e. the owner earns the money, pays taxes on that money, and then pays the premium). This is true of all cash-value life insurance.

Many people felt the returns of standard universal- and whole-life insurance policies were too low. Life insurance was not a good “investment.” The cash-value account was not earning a suitable return. Variable life allows these same people to purchase life insurance and choose the investments for the cash-value account of the policy.

Risk

Many of the sub-account choices within a variable policy invest in stocks. Historically, stocks have earned higher returns than bonds and mortgages (which are used for fixed universal- and whole-life cash-value accounts). The down side is that stocks are much more volatile than other, “safer” investments. They can go up, but they can also go down. There is a risk that a stock investor will lose money, and if the owner invests all of the money in the cash-value account in stock sub-accounts, then he or she runs the risk that the return on the cash-value account will be negative.

Many variable life insurance policies also offer bond sub-accounts. However, unlike fixed whole- and universal-life cash-value accounts, the insurance company does not guarantee these funds, so they can also lose money.

Many variable policies do offer a guaranteed “fixed” account. The guarantees are usually for at least 3 percent or 4 percent.



Sub-Account Options

For most variable-life owners, agents will suggest that the owner choose several different sub-accounts to “diversify” the investments. Diversifying the investments means that the owner picks several different types of sub-accounts (i.e. big company stock funds, small company stock funds, international stock funds, bond funds, and money market funds). The thought behind this strategy is that if one type of sub-account is not performing well, perhaps another type of fund will perform better, and help make up for the poor performance of the first sub-account. However, the owner can choose to put all of the money into one sub-account. Many policies also allow the owner to switch between sub-accounts. Because the cash-value account is protected by the tax rules of life insurance, no taxes are ever owed when changing from one sub-account to another.

Who Would Not Want a Variable-Life Policy?

Variable universal-life is not for those who cannot tolerate risk. The cash value of a variable policy (if invested in stocks and bonds) may lose money. The losses can last days, months, or even years. Variable-life owners have to accept this fact, and think long term.

Who Would Want a Variable-Life Policy?

If the owner understands the risks associated with investments in stocks and bonds, but is willing to take those risks for the chance of higher returns, then a variable universal-life policy may be the best choice.

Past performance is not an indicator of future results, but historically, stock funds have enjoyed strong returns (over 10 percent). If the variable universal-life insurance policy is able to earn strong returns into the future, then the cash-value account will grow at a faster rate. If you have an Option B policy as the cash-value account increases, the *death benefit* increases and the

beneficiary receives that increased amount upon the death of the *insured*. It could also mean less out-of-pocket premiums for the owner.

Definitions of Terms

Beneficiary – The person or entity receiving the death benefit at the death of the insured.

Cash Value – The amount of total premiums paid for a policy minus the costs for insurance in whole-, universal-, and variable universal-life policies. The cash value grows tax-free in an insurance policy.

Death Benefit – The total cash payment made to the beneficiary upon the death of the insured.

Insured – The person on whose life the insurance has been purchased. If the insured dies, a death benefit will be paid to the named beneficiary.

Owner – The person or entity who owns the insurance policy. The owner may or may not be the insured. The owner can designate the beneficiary, and is responsible for paying premiums. See *Life Insurance: The Impact of Ownership*, Virginia Cooperative Extension publication 354-142, for more information on the impact of ownership.

Premium – The amount billed to the owner of an insurance policy (usually monthly, quarterly, or annually) by the insurance company. In term and whole-life the full premium must be paid to keep the insurance. In universal- and variable universal-life, the amount billed may or may not be a mandatory payment to keep the insurance.

Other Sources

For more information on whole life insurance, see the following sites: Life and Health Insurance Foundation for Education (<http://www.life-line.org>), the American Council of Life Insurers (<http://www.acli.com>), and the Insurance Information Institute (<http://www.iii.org>).