SOCIETY OF ACTUARIES

Article From:

The Actuary

October 1987 – Volume No. 21, Issue No. 8

An Answer to the Loan Dilemma

by John W. Keller

The phase-out of the deductibility of policy loan interest as a result of the new tax law is creating problems for both policyowners and life insurance companies. Policyowners, who purchased life insurance on minimum outlay payment plans that depended on the deductibility of policy loan interest, may now find themselves holding policies that require increasing cash outlays each year and provide decreasing death benefits. Companies are finding that policies with large policy loans are very vulnerable to replacement by either their own or some other company's universal life policy.

Northwestern Mutual is attacking this problem vigorously in a program we call "Fresh Start." Through it we provide our agents with the ability to demonstrate to their policyowners — via illustrations of inforce policies — the long-range effects of three possible courses of action. It is up to the policyowner — with the help and advice of the agent — to decide which course of action is best.

The first choice, and the simplest, is to keep the loan as it is. Even when policy loan interest is not deductible, a policy loan is still a pretty good deal. For a typical participating policy with direct recognition, the spread between the loan interest rate and the borrowed dividend interest rate is not that large.

Repaying the loan may also look attractive to a policyowner in today's economic environment. If the policyowner has funds invested at 8, 9, or even 10%, it may be very attractive to use those funds to repay the policy loan. Our current dividend scale will pay a competitive rate on those funds with no taxes on the earnings until or unless the policy is surrendered.

For those who are convinced that they do not want to keep their policy loans and do not have the funds to repay the loans, we are offering a third option which, although similar to an internal replacement, is actually quite different. We will offer to restructure the policy — via policy change — to a new contract which we have developed and called Inforce CompLife® The policy will retain its original policy date and policy number. It will also retain its original policy loan interest rate, whether that is 5, 6, or 8%.

Inforce CompLife® is made up of paid-up additions and level-premium, participating term insurance. The cash value of the existing policy is used entirely to purchase paid-up additions. The balance of the coverage desired is made up of term insurance. Dividends are used to buy paid-up additions which decrease the term insurance amount each year. The premium for the policy is made up of a premium for the term insurance and, if desired, level additional premiums which are payable annually and used to purchase more paid-up additions. Paid-up additions purchased by additional premiums can be used either to reduce the term coverage or to increase the total death benefit.

Most policyowners will find that they can change to Inforce CompLife® for an amount that is the same as or higher than their present coverage for their current premium amount. No underwriting will be required for a change to Inforce CompLife® if no increase in coverage is requested. Increases in coverage will be underwritten.

The design of Inforce CompLife® is similar to the CompLife® design available for new sales, but differs in two significant respects. First, it does not charge the insured for new, first-year-issue expenses or new first-year commissions to the agent. Hence the policyowner avoids the heavy first-year charges associated with a new policy. Second, Inforce CompLife® reflects the duration of the original policy when determining dividend mortality charges for a continuation of present coverage. If the policy contains increased coverage with new underwriting evidence supplied, the dividend mortality charges will reflect a newly select mortality for the increase. In this way, we preserve equity in mortality for our entire block of inforce policies, whether or not they elect to change.

Offers to make changes to Inforce CompLife® will not be mailed directly to policyowners from the home office. Rather, we will furnish agents with computer-selected lists of their policyowners who are most likely to benefit — those with large loans, measured both in absolute dollars and in percent of cash value. Agents then can order inforce ledgers illustrating what would happen to the policy with or without the change. The changes will be handled in the home office by a special unit which will do nothing but these types of policy changes. That unit will be aided by a very sophisticated computer system that handles all the policy change calculations, record changes, and printing of the new policy. This system, developed specifically for this project, will have long-range benefits for the company in that it will eventually facilitate many other types of policy changes.

Agents receive a one-time service fee for helping their client to make a change to Inforce CompLife® Only increases in premium involved in the change receive normal, first-year commissions.

As part of the change to Inforce CompLife® the policyowner has the option of eliminating any policy loan or carrying it forward. If the policy has not built up a taxable gain, then the loan can be eliminated as part of the policy change without any adverse tax consequences. However, if there is a gain in the policy, the policyowner may want to carry the loan over to the new Inforce CompLife® policy rather than eliminating it and having to pay tax on the gain.

As a company, we are very excited about this project. The special policyowner service unit is in place now, and it is expected to be in operation throughout 1988. Agent interest is very high, and we expect to change between 50,000 and 100,000 policies before the program ends.

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