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How Low Interest Rates Impact Your Insurance Coverage

One of the singular benefits of COVID-19 may well be the incredibly low interest rates that have allowed millions of Americans to purchase or refinance a home—saving consumers hundreds or thousands of dollars a year. While these low rates are advantageous to consumers in many ways, insurance companies, which provide the safety net we rely on for health, life, home, auto, and other types of protection, see a large negative impact. These businesses are required to invest most of the premium dollars they receive in high-quality bonds. Today, high-quality bonds have very low interest rates and, thus, low corresponding returns. »

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Why should you care about whether insurance companies are potentially earning a lower return on their investments? The amount we pay insurance companies in premiums depends on their ability to earn an adequate level of investment return, which is generally thought of as the difference between the amount they earn on their investment portfolio and the cost to service policies—either through claims or crediting the policy dividends. Therefore, persistently low interest rates may impact insurers in various ways, including lowering earnings, decreasing liquidity, and eroding competitiveness.[1] To mitigate these effects, insurers will likely increase the cost of insurance policies with variable premiums for many types of insurance coverage (such as life, long-term care, home, auto, and umbrella insurance) in the years ahead, shifting cost burdens to consumers.

Of all the types of insurance that may be affected, life insurance warrants special consideration because the impacts can be more hidden. Life insurance policies have a greater potential to underperform and thus either fall apart or require more years of premium payments. Let's explore this further, starting with a brief recap of the types of life insurance: term, whole life, and universal life.

Term is the most straightforward, providing a death benefit only if you pass away before the end of the predetermined coverage period. At the time you apply, you choose how long you want coverage, say 20 years, and the annual cost is generally set up either to be the same for each of the 20 years or to start lower and increase by a preset amount each year. Unless you are applying for new term insurance, you are unlikely to see a change in premiums based on low interest rates.

Whole life is designed to make sure an insurance benefit is paid at the end of someone's life, whenever that happens. It can contain a variety of features, including accumulation of cash value, the ability to borrow "against" the policy, and receipt of dividends from the insurance carrier. These policies act as an investment and insurance hybrid, though at a significantly higher premium cost than term policies, since these are designed to be there for the rest of your life.

Universal life policies come in several different flavors, including guaranteed, index, or traditional. We won't get into details on these policies here,[2] but many policies issued more than 10 years ago are likely traditional universal life. They embed assumptions on what the investment return for the insurance carrier will be and include a minimum return the carrier is required to credit to the policy.

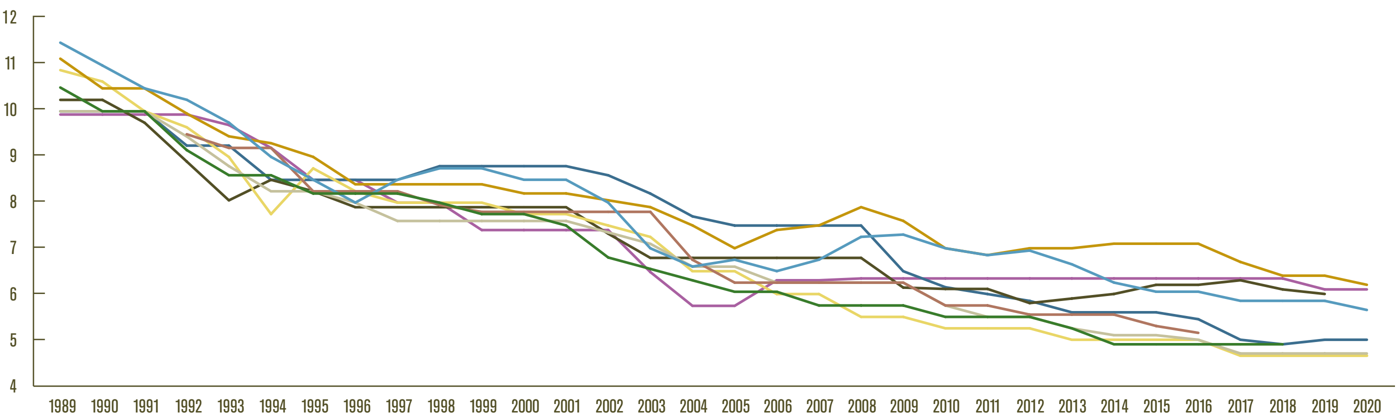
In low-interest-rate environments, traditional universal life and whole life policies are at risk of underperforming what the agents and carriers assumed when they sold those policies—potentially by a meaningful amount. While carriers have generally done a good job of managing their solvency through careful matching of asset and liability cash flows, their investment underperformance does create a couple of risks to consider.

Underperformance—If a policy performs at or near its minimum rate over several years, it may require an infusion of cash from the insured just to prevent it from defaulting. Imagine a policy designed to last until age 100+, for which you may have already paid tens of thousands in premiums, suddenly going away.

Lower Dividends—One of the key benefits of whole life policies when they are sold to consumers is the dividend. Carriers love to illustrate how great these dividends have been, without emphasizing past tense enough. From 1989 through the end of 2020, insurance carriers consistently lowered dividend rates, which are now roughly half of what they were at the start of this period (Exhibit 1). »

EXHIBIT 1 HISTORICAL WHOLE LIFE DIVIDEND RATES 1989-2020

Carrier	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
General American	10.52	10.00	10.00	9.15	8.60	8.60	8.20	8.20	8.20	8.00	7.75	7.75	7.50	6.80	6.55	6.30	6.05	6.05	5.75	5.75	5.75	5.50	5.50	5.50	5.25	4.90	4.90	4.90	4.90	4.90	N/A	N/A
Guardian	11.50	11.00	10.50	10.25	9.75	9.00	8.50	8.00	8.50	8.75	8.75	8.50	8.50	8.00	7.00	6.60	6.75	6.50	6.75	7.25	7.30	7.00	6.85	6.95	6.65	6.25	6.05	6.05	5.85	5.85	5.85	5.65
John Hancock	N/A	N/A	N/A	9.50	9.20	9.20	8.25	8.25	8.25	7.95	7.80	7.80	7.80	7.80	7.80	6.75	6.25	6.25	6.25	6.25	6.25	5.75	5.75	5.55	5.55	5.55	5.30	5.15	N/A	N/A	N/A	N/A
MassMutual	11.15	10.50	10.50	9.95	9.45	9.30	9.00	8.40	8.40	8.40	8.40	8.20	8.20	8.05	7.90	7.50	7.00	7.40	7.50	7.90	7.60	7.00	6.85	7.00	7.00	7.10	7.10	7.10	6.70	6.40	6.40	6.20
MetLife	10.00	10.00	10.00	9.45	8.80	8.25	8.25	8.00	7.60	7.60	7.60	7.60	7.60	7.35	7.10	6.60	6.60	6.25	6.25	6.25	6.25	5.75	5.50	5.50	5.25	5.10	5.10	5.00	4.70	4.70	4.70	4.70
New England Financial	10.90	10.65	10.00	9.65	9.00	7.75	8.75	8.25	8.00	8.00	8.00	7.75	7.75	7.50	7.25	6.50	6.50	6.00	6.00	5.50	5.50	5.25	5.25	5.25	5.00	5.00	5.00	5.00	4.65	4.65	4.65	4.65
New York Life	10.25	10.25	9.75	8.90	8.05	8.50	8.25	7.90	7.90	7.90	7.90	7.90	7.90	7.32	6.79	6.79	6.79	6.79	6.79	6.79	6.14	6.11	6.11	5.80	5.90	6.00	6.20	6.20	6.30	6.10	6.00	N/A
Northwestern Mutual	10.00	10.00	10.00	9.25	9.25	8.50	8.50	8.50	8.50	8.80	8.80	8.80	8.80	8.60	8.20	7.70	7.50	7.50	7.50	7.50	6.50	6.15	6.00	5.85	5.60	5.60	5.60	5.45	5.00	4.90	5.00	5.00
Penn Mutual	9.93	9.93	9.93	9.93	9.70	9.20	8.50	8.50	8.00	8.00	7.40	7.40	7.40	7.40	6.48	5.74	5.74	6.30	6.30	6.34	6.34	6.34	6.34	6.34	6.34	6.34	6.34	6.34	6.34	6.34	6.10	6.10



Source: FAIR Insurance Solutions

Three Life Insurance Actions to Take Now

1. Perform a quick review. It's always a good idea to be reminded of what coverage we have. Pull out the policies gathering dust, and look at the carrier, amount of coverage, cost, and, of course, the type of policy you have.

2. Request an illustration. If you have a whole life or universal life policy, call the carrier shown on the policy and ask them to provide you an "in-force illustration" using the current dividend or crediting rates. We do this to better understand how the policy we bought is performing and whether there are risks that it won't earn the necessary return to remain solvent with the current level of premiums.

3. Schedule time with your RMB advisor. Heed the old adage, "There is no time like the present." In this case, set a time with your advisor to review your policy and the in-force illustration, so we can ensure the policy is still working effectively as part of your plan. ■

1 *National Association of Insurance Commissioners, "Low Interest Rates," 9/3/2020, https://content.naic.org/cipr_topics/topic_low_interest_rates.htm.*

2 *For more information on life insurance, see "Time to Dust Off Your Life Insurance Policy" from our Summer 2016 issue of INVESTED.*