Variable Universal Life Insurance

Variable universal life insurance policy combines features found in both universal life policies and variable life policies. As with a variable life policy, a variable universal contract permits the policyowner to allocate a portion of each premium payment to one or more investment options, in separate subaccounts, after a deduction for expense and mortality charges. An annual statement detailing the expenses, charges, and credits allowed a policyowner to track performance over time.

Following universal life policies, a variable universal contract permits the owner of a policy, within certain guidelines, to modify the policy death benefit, and change the amount and timing of premium payments, to meet changing circumstances. The ultimate death benefit is subject to the claims paying ability of the insurer.

Because the investment options available inside a variable universal life policy usually involve securities (e.g., stocks and bonds), the Securities and Exchange Commission (SEC) requires this type of policy to be accompanied by a prospectus. The prospectus provides detailed information on how the policy works, its, risks, and all expenses or charges involved. The SEC also requires individuals selling variable universal life policies to be licensed to sell securities.

Policy Variations

There are two primary variations of variable universal life, based on the level of death benefits:

- **Type I variable universal life:** Also known as option A, type I variable universal policies pay a fixed, level death benefit, generally the face amount of the policy.

- **Type II variable universal life:** Also known as option B, type II variable universal policies generally pay the face amount of the policy plus the accumulated cash values. If the cash value grows, so does the potential death benefit.

Common Uses of Variable Universal Life

Variable universal life policies are useful for policyowners who expect their needs to change over time. Within certain guidelines, the policy can be modified by changing the death benefit or premium payments. They are also well suited for use by policyowners who are comfortable with the risks and rewards of investments, or who need life insurance with the potential to provide an increasing death benefit. Some common uses are:

- **Supplement existing family protection:** Acts as a supplement to an existing, basic life insurance plan. If the market is down when an insured dies, the variable death benefit of a variable universal life policy may not provide adequate funds to support a surviving spouse and/or minor children, or to pay final estate expenses.

- **Business planning:** Because of its flexibility, VUL insurance is often used for many different business purposes, such as insuring key employees, in split-dollar insurance arrangements, and funding nonqualified deferred compensation plans. Business continuation planning often involves VUL insurance as a source of funds of buy-sell agreements.

- **Accumulation needs:** Some individuals will use the investment features of VUL as means of accumulating funds for specific purposes, such as funding college education, or as a supplemental source of retirement income.

- **Charitable gifts:** To provide funds for a gift to charity.

Modified Endowment Contracts (MECs)

A life insurance policy issued on or after June 21, 1988 may be classified as a modified endowment contract (MEC) if the cumulative premiums paid during the first seven years (7-pay test) at any time exceed the total of the net level premiums for the same period.[1] If a policy is classified as a MEC, all withdrawals (including loans) will be taxed as current income, until all of the policy earnings have been taxed. There is an additional 10% penalty tax if the owner is under age 59 ½ at the time of withdrawal, unless the payments are due to disability or are annuity type payments.

A VUL policy can avoid treatment as a MEC through a well-designed premium payment schedule.

[1] Including a policy issued before that date, but later materially changed.

Additional Policy Elements

Variable universal life policies have a number of additional elements to consider:

- **Investment options:** Most VUL policies offer a policyowner a wide range of investment options, including basic stock, bond and money market funds. Depending on the policy and insurer, other options, such as index funds, real estate funds, foreign stock funds, or zero-coupon bond funds may also be offered. A policy may also include a fixed account option, in which the insurer guarantees a fixed rate of return.

- **Policy loans:** VUL policies typically permit the policy owner to borrow at interest a portion of the accumulated cash value, with the insurance company charging interest on the loan. The rate charged on the borrowed funds is often lower than current open market rates. A policy loan will reduce the death benefit payable if the insured dies before the loan is repaid; a policy loan will also reduce the cash surrender value if a policy is terminated. If the policy lapses or is surrendered with a loan outstanding, the loan will be treated as taxable income in the current year, to the extent of gain in the policy.

- **Partial withdrawals:** Most VUL policies allow a policy owner to withdraw a portion of the cash value, without terminating the policy. Such withdrawals reduce the amount of death benefit payable, and may be subject to current income tax, if the policy is classified as a MEC, or if the withdrawal exceeds cost basis for a non-MEC policy. Some contracts allow a policy owner to put the withdrawn funds back into the policy, but the insured may have to provide evidence of insurability to restore the original death benefit.

- **Surrender charges:** Most VUL policies have substantial surrender charges, if a policy is terminated. These surrender charges are generally highest in the early years of a policy, and decline over a period of time, usually from seven to 15 years.

- **Surrender options:** If a policy owner surrenders a policy, there are generally three ways in which the accumulated cash value may be received, including: (1) taking the accumulated cash value, less any surrender charges; (2) received a reduced amount of paid-up insurance; or (3) taking paid-up term insurance in an amount equal to the original face amount of the policy.

Optional Policy Provisions

A number of optional policy provisions, commonly referred to as riders, can be added to a basic variable universal life policy, generally through payment of an additional premium. Not all riders are available from all insurance companies.

- **Waiver of premium:** Waives the payment of policy premiums if the insured becomes disabled and is unable to work.
- **Accidental death:** Pays the beneficiaries double (in some situations triple) the face amount of the policy if the insured dies in an accident.
- **Spousal or family term insurance:** Allows a policy owner to purchase term insurance on a spouse or children.
- **Accelerated death benefits:** An accelerated death benefits provision allows for payment of part of a policy's death benefit while an insured is still alive. Such benefits are typically payable when the insured develops a medical condition expected to lead to death within a short period of time.

Variable universal life insurance policies are primarily intended to meet long-term insurance needs. Your Jacobi Capital team is available to explain the nuances of a policy, or help you choose the policy that's appropriate for your needs and long-term goals.

Content in this material is for general information only and not intended to provide specific advice or recommendations for any individual.