What You Need to Know About Whole Life Insurance Dividends

Why the Dividend Rate Is Only *Part* of the Story

Plus...

A Comprehensive Analysis of Participating Whole Life Insurance Dividends for the Past 20 Years (updated for 2018)

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Introduction

We started putting together the dividend variation analysis back in 2013 to address our concerns about the way life insurance companies established and proclaimed dividend interest rates. The process is misleading.

Life insurers generally announce dividends to participating policyholders by publishing the total of dividends paid and (usually but not always) by announcing the dividend interest rate or the effective dividend interest rate this payment represents to policyholders.

First, you should know this…

The total dividend payment to all policyholders is a vanity metric with no real meaning. As such, we will not be discussing it further in this analysis.

The dividend interest rate, on the other hand, is a source of much confusion for policyholders and of great manipulation by life insurers.

Seeking a Competitive Advantage

Life insurers function just like any other for-profit enterprise. They seek out competitive advantages in an attempt to offer you an incentive to do business with them.

When it comes to whole life insurance, companies have often used the promise of cash benefits as a major benefit to purchasing the product. For participating whole life insurance, the key driver of this cash benefit is the dividend the company pays to policyholders.

If you're focused on the accumulation of cash value, the dividend is incredibly important. So, it comes as no great surprise that life insurers and life insurance marketers would highlight dividends in press releases, corporate announcements and marketing collateral.

Dividend interest rates, are but one component of the dividend and are thus guilty by association. In fact, these numbers (dividend interest rates) have become a primary point of comparison amongst companies that issue participating whole life insurance.

We contend that comparing dividend interest rates across companies is a tremendous waste of time and will lead you to reach false conclusions. There's a lot of posturing and comparing who is paying the most dividends and who will likely pay the most in the future. We implore you to ignore the chest-thumping.

In past years, A.M. Best published a report on whole life insurance policies that tracked the actual cash value and death benefit accumulation performance of several whole life insurance policies issued by a few life insurance companies. The information was not difficult to aggregate as it was part of required disclosure for insurance accounting purposes once upon a time.

Unfortunately, that all ended sometime in the early 90's and with it went A.M. Best's "dividend review."

After the demise of that report, former A.M. Best employee and well-connected financial analyst, Roger Blease, attempted to revive the report on his own by using actual historical data from participating whole life insurance policies and for a time this comparison was his company's flagship product.

Sadly, Mr. Blease passed away a few years ago and with his passing went his company and its research into historical whole life insurance value performance.

When the companies reported historical whole life insurance policy performance, they always had a penchant for using declared dividend interest rates to indicate or at least imply, value.

Logic that follows this sort of pattern…

"*Northwestern Mutual's 8.5% dividend rate is higher than Guardian's 7.80% dividend rate, and therefore Northwestern Mutual is better*"

That's the sort of hypothetical statement we hear all too often.

8.5% of What Exactly?

The problem with dividend interest rates is that they only tell you part of the story, you are looking at incomplete data. The dividend interest rate is just a single variable used to calculate a life insurers *total* dividend payout.

Actually, it's more of reconciliation than a calculation.

We make this distinction because you need to understand that insurers are not plugging a random number into their formula, taking the solution and saying "well, I hope we have enough money in the bank to pay it."

Instead, they first determine the amount of money the company is willing to pay policyholders. After that, the company decides what the variable amounts are for determining who gets what. The factors that influence those decisions depend upon the profitability of several different tranches of life insurance policies.

Remember, nearly all companies that issue participating whole life insurance have multiple blocks of business (some are old and closed while some are open and issuing) and they may choose to pay varying dividend amounts to each block.

The dividend interest rate merely tells us the input value for that variable. It's merely one part of the dividend that is paid.

For example, if a life insurer declares an 8.5% dividend interest rate in 2018, it means they intend to use 8.5% as the input for the part of the calculation that determines a specific policy's dividend and that is attributed to the investment component of that policy.

<u>It does not mean that the policyholder will earn 8.5% on their cash value</u>.

No, it means the part of the equation that computes the effect of investment return on the dividend will be some number multiplied by .085. The value of that "some number" is never disclosed and is considered proprietary information.

This is a crucial distinction because it highlights the tendency to misuse, abuse, and misunderstand the functionality of dividends and the dividend interest rate.

Returning to the example of Northwestern Mutual and Guardian, it's tempting to suggest that Northwestern's declared 8.5% dividend rate must be better than Guardian's 7.80%.

Basic math we all learned in elementary school tells us that 8.5 > 7.80.

The problem is we're only seeing one part of the formula. I assure you 8.5% is greater than 7.80%. However, 8.5% of $100,000 is certainly not greater than 7.80% of $120,000.

You Cannot Compare Between…
But You Can Sort of Compare within

Given this fact, it should be evident that comparing the declared dividend rate from one company to another is a waste of time.

It tells us virtually nothing about what to expect from one insurer vs. another. We can, however, arrive at some degree of understanding by comparing the dividend interest rate of a life insurer against its past dividend interest rates.

Looking at how the dividend interest rate has changed over time for a specific insurer gives us an indication of the insurer's financial performance. Understanding that performance, is meaningful to the average policyholder (current and future). Dividend interest rates that suffer from volatility or that experience sharp declines may indicate a low accuracy of company projections.

Our analysis seeks to instill confidence in your ability to assess a policy's likelihood of achieving your desired result. But you have to ask yourself, or at least you should ask yourself…how accurate is the dividend assumption?

Consider this…

Every time someone purchases a life insurance policy that has cash value (permanent insurance), state law requires that this person see a document outlining policy features.

The document always includes a ledger (or several) that project future policy values given an assumption about premiums the insured will pay. Most people believe that the ledgers are suspect and inaccurate at best (like most projections), but much effort is made to ensure the figures are somewhat reliable at least in the short term (i.e., the next couple of years).

Life insurance agents use the ledgers to compare values across multiple whole life policies issued by different life insurers. So, of course we all hope to have a degree of confidence in the accuracy of the figures.

But how accurate is the dividend assumption in the illustration?

We think that very much depends on the analysis. Historically, the companies who have lower standard deviation and a more shallow dividend decline have been more accurate with their illustrated values.

Our Dividend Variance Analysis

As mentioned above, we find value in the announcement of a new dividend interest rate insofar as we can use it to compare what happens year over year. It allows us to evaluate the volatility of the dividend interest rate at an insurer and the general trend of the dividend interest rate.

But…

You have to keep in mind, the dividend interest rate is *not* the only factor that determines the actual dividend payment to policyholders--though it is usually the most significant contributor to the dividend payment.

We cannot overlook the fact that claims experience (underwriting profits) and general operating expenses also affect the total dividend payout. Several life insurers have grown beyond just being life insurance companies and instead operate as large financial holdings companies. With this sort of operation, there could be subsidiary businesses that contribute profits that contribute to the payment of dividends to policyholders.

The 2018 Whole Life Dividend Analysis - Methodology

We took dividend interest rate information from six leading life insurers who lead the marketplace for whole life insurance sales. In 2018, we deleted MetLife from the analysis following Met's divestitures and selloff permanently exiting the whole life marketplace.

Companies included in the analysis are Guardian Life, MassMutual, New York Life, Northwestern Mutual, Ohio National, and Penn Mutual.

All of these insurers have been a part of our analysis since it began in 2013.

We calculated the standard deviation and compound annual growth rate of declared dividend interest rates among all insurers using data of reported dividend interest rates for the preceding 10 years.

New this year, we also performed the same standard deviation and compound annual growth rate calculations for the preceding 20 years.

In the past, we have avoided this particular analysis because we felt the turnover at each company left it unlikely that the same people controlled investment decisions for all 20 years nor would they far into the future.

But we have received more than a handful of requests for the 20-year analysis so we decided to add it this year.

Also, this year we have further investigated disclosure data from all of these insurers to review what other dividend actions have taken place. Remember, we said the dividend rate is only one part of the dividend.

<u>Please don't skip over that</u>…this sort of information is not reported with the same fanfare as dividend interest rates. We find this information to be the most fascinating and perhaps more meaningful than dividend interest rates.

That being said, we created a special section just to include that additional information.

2018 Whole Life Dividend Analysis - Results

Following the trends from previous years, the general movement of the dividend interest rate among insurers is downward:

Company	10 Year Compound Annual Growth Rate
Penn Mutual	0.00%
New York Life	-0.07%
MassMutual	-1.51%
Ohio National	-1.68%
Guardian	-2.19%
Northwestern Mutual	-2.79%

Guardian and Northwestern Mutual experienced the most significant declines in dividend interest rate over the 10-year period. Penn Mutual and New York Life suffered the least amount of decrease Penn Mutual has maintained the same dividend rate in all ten years.

The standard deviation for declared dividend interest rates over this ten year period is as follows:

Company	10 Year Standard Deviation
Penn Mutual	0.00%
New York Life	0.14%
MassMutual	0.27%
Ohio National	0.28%
Northwestern Mutual	0.47%
Guardian	0.51%

Interestingly, but not altogether surprising, the insurers with the most substantial decline in dividend interest rates are also the most volatile.

This is not necessarily a function of inconsistent dividend payments (i.e., a tendency of the company to continually raise and then lower the dividend interest rate); instead a result of the movement (downward) of dividend interest rates over the last 10 years.

The 20 Year Analysis

The 20-year results paint a slightly different picture:

Company	20 Year Compound Annual Growth Rate
Penn Mutual	-0.77%
New York Life	-1.28%
MassMutual	-1.35%
Guardian	-1.99%
Ohio National	-2.13%
Northwestern Mutual	-2.89%

Northwestern Mutual continues to show the sharpest decline, but Guardian fares slightly better than their 10-year CAGR. Ohio National's result is a bit worse over 20 years vs. 10 years.

Penn Mutual continues to experience the smallest drop in the dividend interest rate over this period as well (due in large part to not changing their DIR in the past 10 years). New York Life's decline gets a bit worse while MassMutual's improves a bit.

Standard deviation shows an interesting result:

Company	20 Year Standard Deviation
Penn Mutual	0.49%
MassMutual	0.57%
New York Life	0.66%
Guardian	0.85%
Ohio National	0.88%
Northwestern Mutual	1.32%

Here, the top three insurers are much closer to one another than is the case in the 10-year results.

Northwestern Mutual breaks away from the pack in its last-place position. It's worth noting that the dividend interest rate for all insurers experienced increased volatility for the 20-year analysis.

The Benchmark: 10-Year Treasury Bond

The 10 Year Treasury has long been the reference point for whole life insurance dividend interest rates. As such, it seemed appropriate to calculate the same standard deviation and compound annual growth rate on the 10 Year Note to see how it compares to these insurers.

For 10 years:

Compound Annual Growth Rate: 0.24%

Standard Deviation: 0.6%

For 20 years:

Compound Annual Growth Rate: -2.97%

Standard Deviation: 1.28%

We should point out that the compound annual growth rate does not indicate what someone would have earned if they had invested in 10 Year Treasuries, it's merely a calculation of the growth in yield of the bonds over this period.

The 20-year trend seems to match whole life dividends pretty well (both declining over the period), however the 10-year trend is a bit different. We suspect this is a result of insurers holding higher dividend interest rates during the initial decline in interest rates and then needing to reduce dividends as the prolonged period of lower interest rates became an unfortunate reality.

Bonus Section: The Devil in the Details

New to this analysis is the review of filing data that discloses more precise dividend movements or actions taken by life insurance companies that impact dividend payments. This information speaks to more than just the dividend interest rate and gives insight into the entire dividend movement across all whole life business for a given company.

There is no concise way to compare this data across insurers, so we are instead presenting it as a synopsis per insurer.

Guardian Life

Guardian reported no change to the dividend payable on all blocks of business. They report nine different whole life blocks: eight issued initially by Guardian and one issued by Berkshire Life (a wholly owned stock subsidiary company of the Guardian).

Guardian maintains a separation between existing whole life policies that receive direct recognition treatment and non-direct recognition treatment. Guardian plans no difference in the dividend paid on this policies during 2018 vs. 2017.

In addition, Guardian has a practice of leveling the actual dividend paid on the base whole life policy. This practice means Guardian pays existing policyholders a higher dividend (the prior year dividend) if the newly declared dividend interest rate is lower.

Guardian also uses an average of preceding dividend rates that can be paid to current policyholders (if higher) than the currently declared dividend interest rate. Neither of these features is contractually guaranteed and are evaluated annually by Guardian.

MassMutual

MassMutual stated a decline on average across all major blocks of business. This breaks down into three categories: Connecticut Mutual (a subsidiary acquired by MassMutual years ago), MassMutual, and MassMutual Tobacco Class.

The Connecticut Mutual block fared the best, declining by -2.6%. The MassMutual Tobacco Class fared the worst with an average fall of -8.1%. The regular MassMutual block reduction was -5.5%.

New York Life

New York Life reports 21 different blocks of whole life insurance business. Nearly all saw declines in the payable dividend.

New York Life differentiates between the loan type chosen on older blocks and does differ the dividend on these policies depending on the loan selected.

They differentiate dividends payable on regular whole life policies with continuous premium payments vs. paid-up policies and paid-up additions. For policies that are paid-up and for paid-up additions, the dividend payment has declined more (i.e., New York Life is paying fewer dividends on paid-up policies and paid-up additions.)

Northwestern Mutual

Northwestern Mutual reported five blocks of whole life business. They reduced dividends payable on older blocks more significantly than on newer blocks. Declines in the older blocks totaled -2.8% vs. -0.9% on the latest block.

Northwestern noted that adjustments were made for mortality experience (some increased and some decreased). They also increased dividends for policyholders who had "certain benefits." This likely constitute a refund of premium for a rider that has proven less expensive than Northwestern planned initially.

Ohio National

Ohio National reported five blocks of business. Some of these blocks fall under their "closed" distinction, which represents business written before Ohio National's organizational shift from a few decades ago.

The other blocks fall under Ohio National's "open" blocks, which are policies issued by the company under its current structure. Our dividend analysis has always focused on the dividend interest rate declared for the "open" block of business.

Ohio National decreased payable dividends on all blocks of business. The most significant reduction was on a “closed” block of business, that reduction was -23.7%. The smallest decrease was on the current block of business of -7.0%

Interestingly, Ohio National placed an additional expense charge on "open" blocks last year.

For 2018, *this expense will double* vs. the 2017 expense.

It's difficult to quantify the precise impact of this expense charge and how it makes the net decrease in dividends payable compare to the old block of business. We can say that the net reduction is undoubtedly more than the reported -7.0%.

Penn Mutual

Payable dividends did not change for Penn Mutual for 2018.

In 2015 Penn Mutual did increase the payable dividend on five old blocks of business (this increase did not include the most recent block of business). The dividends on these blocks have not changed for 2018 either.

What Next?

You will find all sorts of information available on theinsuranceproblog.com from a range of topics that relate to life insurance, dividends, and using paid up additions with participating whole life insurance.

Here are a few that you should check out:

How to Create Flexible Whole Life Insurance

Historical Proof that Blended Whole Life Really Works

Whole Life Insurance Pros and Cons

Participating Whole Life Income Comparison

Infinite Banking Lies About Indexed Universal Life and Whole Life Insurance

If you have feedback for us, we welcome it.

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