Participating Whole Life 101

# Direct v. Non-Direct *Recognition*

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## Ever wonder what the difference is between Direct and Non-Direct Recognition policy loans and what effect each may have on the cash value of a life insurance policy?

### Direct Recognition Policy Loans

When an insurance company uses Direct Recognition for their policy loans it means that they "recognize" the need to treat the loaned dollars *differently* than the rest of the contract, and they do so by adjusting the dividend rate accordingly.

In most cases, the company will apply a reduced dividend rate to the loaned dollars in the contract and continue to pay full dividends on the policy cash value outside of the loan. The insurance company considers the loan as a lost investment opportunity, and therefore acknowledges that it has to compensate for that loss in some way.

### Non-Direct Recognition Policy Loans

When an insurance company uses Non-Direct Recognition for their policy loans it means that they treat the loaned dollars the same as the rest of the contract. The result is that the dividend will not affect the portion of the cash value that has been loaned out.

There is an unseen disadvantage to Non-Direct Recognition loans:

Since Dividends are declared and set for the entire policy year, a Non-Direct Recognition company cannot just reduce the declared dividend if the economy takes a turn and their investments are negatively impacted. So if the company's total returns are affected in a negative way, the company needs to figure out some solution to make up for this loss in their portfolio. The most common solution that they use is adjusting the interest rates for the loans that they have on the books.
For example, between 2022 and 2023 non-direct recognition loan rates jumped from 3% to 5.7% +, in tandem with the federal reserve increasing interest rates.