Life Insurance as an Asset Class: A Value-Added Component of an Asset Allocation
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1. Life Insurance Basics

A. What is the right price to *pay* for life insurance (when no one wants to pay more than they have to)?

i. The answer is predicated on knowing "how long will you *need* life insurance?"
ii. Short term / intermediate term / lifetime *price* for a 33-year old healthy male
iii. Value statistics
   a. Regardless of the starting age, term insurance will cost approximately 70% of the death benefit through life expectancy
   b. Term life insurance cannot effectively or affordably provide insurance for the entirety of one's life, unless we are unlucky enough to die substantially before life expectancy.

2. The policy "Illustration Beauty Contest" - the attractive *impossibility* versus the less attractive *probability*

A. $6,000 or $12,000 premium per year - which would you pay?
B. The illustration dilemma: how it's portrayed versus how it really works
C. It's all about your minimum threshold for risk

3. Matching permanent policy "styles" to the customer's investment risk tolerance

A. Whole life is generally comparable to the "style" of the conservative investor who is mostly intolerant to volatility and seeks guarantees in most investment choices.

i. Underlying investments are government and high-grade corporate bonds
ii. Premiums are guaranteed
iii. Policy itself is guaranteed
iv. There will be some "upside" potential, but magnitude is not guaranteed

B. No-lapse guarantee universal life is also generally comparable to the "style" of the conservative investor – intolerant of volatility and seeks guarantees

i. The death benefit and premium obligation are guaranteed
ii. Bare bones; "what you see is what you get"
iii. No upside potential for death benefit

C. "Traditional" universal life is generally comparable to the "style" of the balanced investor – tolerant of modest volatility and willing to accept fewer guarantees in favor of premium payment flexibility

   i. The risk of premium "sufficiency" has been shifted to the policy owner
   ii. Policies should be funded with more premium than an illustration is likely to suggest
   iii. No ability to manage the policy owner's risk (premium sufficiency) except by paying more premium.

D. Variable universal life is generally comparable to the "style" of the growth or aggressive investor – tolerant of volatility and willing to lack of guarantees in favor of having the opportunity to manage the underlying investments supporting the policy

   i. The risk of premium "sufficiency" has been shifted to the policy owner
   ii. Policies should be funded with substantially more premium than an illustration is likely to suggest
   iii. Professional management of underlying investment accounts is imperative

4. Modern Portfolio Theory (MPT), Asset Classes, and life insurance

A. Introduction

   i. Diversification is at the heart of MPT
   ii. Correlated versus uncorrelated assets
   iii. Net net returns

B. MPT essentials

   i. Assess a portfolio into component "asset classes"
   ii. Traditional classes
   iii. Diversify with dissimilar categories

C. Life insurance as an asset class

   i. Death benefit is cash
   ii. Living benefits – cash value –take on the asset class attributes of the underlying policy style: whole life = fixed

iii. Life insurance has unique attributes that keep it in a category by itself

a. income tax-deferred accumulation of cash value
b. income tax-free death benefit
c. estate-tax free planning opportunities
d. free from reach of creditors
e. inherent leverage of premium to death benefit
f. death benefit is triggered by the event of death; no market value adjustment
g. policy premiums should be allocated out of investment portfolio assets
h. permanent life insurance can produce a favorable long-term return with less risk within a portfolio of equity and fixed components

D. Life insurance as a value-added component of the fixed component of an asset allocation

i. $500,000 municipal bond example
ii. Risk Index explained
iii. Needed life insurance can reduce risk and increase overall return of portfolio
iv. Two strategies for enhancing retirement income
v. Inherent leverage of premium to death benefit
vi. Death benefit is triggered by the event of death; no market value adjustment
vii. Policy premiums should be allocated out of investment portfolio assets
viii. Permanent life insurance can produce a favorable long-term return with less risk within a portfolio of equity and fixed return components

5. Efficient Choices

A. Introduction

i. The sophisticated form of diversification under MPT is Efficient Frontier Analysis
ii. A similar process can be applied to the efficient selection of life insurance policies intended for lifetime uses

B. MPT indicates that appropriate diversification is how investors maximize returns for a given amount of risk tolerance.

i. The sophisticated form of diversification under MPT is Efficient Frontier Analysis;
ii. A similar process can be applied to the efficient selection of life insurance policies intended for lifetime uses

C. Dominant attributes/qualities of life insurance policies

i. Price (premium outlay)
ii. Cost (the resulting cash value compared to premiums paid)
iii. Access to cash value
iv. Likely natural, long-term death benefit increases
v. Any policy owner risk associated with the investments underlying the policy's reserves

D. Attributes assessment matrix

	Price	**Cost**	**Increases in Death Benefit**	**Investment Risk**
No Lapse UL	Lowest	Highest	None	Lowest
Universal Life	Low	High	Some	Low
Variable UL	High	Low	Good	High
Par Whole Life	Highest	Best	Excellent	Very Low

E. Efficient Choices matrix

i. Conservative Style / Price-focused

0% WL / 70% NLG / 30% VUL with a Risk Index = 4.5

ii. Conservative Style / Value-focused

80% WL / 0% NLG / 20% VUL with a Risk Index = 4.44

iii. Balanced Style / Price-focused

0% WL / 50% NLG / 50% VUL with a Risk Index = 7.5

iv. Balanced Style / Value-focused

60% WL / 0% NLG / 40% VUL with a Risk Index = 7.08

v. Aggressive Style / Price-focused

10% WL / 20% NLG / 70% VUL with a Risk Index = 10.68 – OR –

0% WL / 20% NLG / 80% VUL with a Risk Index = 12.0

vi. Aggressive Style / Value-focused

30% WL/ 0% NLG / 70% VUL with a Risk Index = 11.04

6. Yesterday's new policy is today's "in-force" policy

A. In-force view 10 years after purchase

i. 10th year cash value illustrated as $64,510 "on the curve"
ii. Actual 10th year cash value $60,513 and age 88 lapse
iii. Monte Carlo premium remediation = $15,073 (90% confidence)
iv. Monte Carlo death benefit remediation = $650,000 (90% confidence)
v. Exchange to a new policy? $10,530 / year guaranteed
vi. Surrender or Life Settle

B. New policy to replace "failed" policy

i. 1035 Exchange + annual premium of $10,540 No-Lapse Guarantee
ii. "I don't want to pay more for life insurance than I have to!"

C. Internal Rate of Return analysis on Death benefit

i. $1 million vs $2,796,000 life expectancy death benefit 10.13% IRR
ii. $1 million vs $5,891,000 age 100 death benefit 9.55% IRR

7. *Intelligently* remediating in-force policies

A. Re-funding the original policy

B. Reducing the death benefit of the original policy

i. Initially level DB
ii. Initially increasing DB

C. Exchanging for a new policy

i. Generally effective only if shifting style
ii. Big debate whether "more modern" scale of COI makes sufficient difference to begin with new sales charges, surrender charges, contestable period, etc; begs "migration to mean" expectation

D. Life Settlement

i. Generally practical when review of medical records suggests a specific life expectancy of less than 150 months
ii. Under certain circumstances, may facilitate a more financially favorable exchange to a new policy

8. Assessing older clients

A. VUL as purchased: premium of $20,243 based on a projection of 8% gross

B. In-force view after 2008 market "correction"

C. Revised funding: 70% increase to $34,478

9. Policy management

A. Not your father's Oldsmobile - or life insurance policy

i. Life insurance is property. It should be managed as any other asset.
ii. Expect to pay for expert management advice
iii. Insurance companies are *not* providing analytical tools or data. You're on your own.

10. Trustees of ILITs are especially vulnerable in defending their fiduciary obligations. Issues to explore include

A. Life Insurance Investment Policy Statement

B. Periodic evaluation to determine if policies continue to be suitable and meet expectations

C. Are premiums sufficient to sustain policy?

D. Have variable accounts performed within an acceptable range for the asset classes and planned asset allocation?

E. Have carrier financial ratings deteriorated? Should anything be "done" about that?

F. Examine remediation alternatives

G. Actuarial evaluation is critical

H. Seek periodic review from agents

I. VUL policies should only be considered if the underlying sub-accounts are professionally managed

11. Conclusion

A. Short-term needs are best met with term insurance for the appropriate duration; term insurance can be purchased on the basis of premium and carrier financial ratings.

B. Needs change; current uses for life insurance may transform. We don't always know the answer to the "how long will I need it?" question.

C. Lifetime uses of life insurance require an enhanced level of understanding, assessment, and explanation in order to acquire the right type(s) of policies for specific financial, estate, and portfolio considerations.

D. Policy illustrations are almost always an *inappropriate* means of valuing the price/value proposition.

E. Buyers of VUL should consider scaling back their initial asset allocation as they get older.

F. Permanent life insurance has unique characteristics that qualify it as an asset class in the context of an investment portfolio that *includes* a life insurance policy.

G. Lifetime uses and needs for life insurance can enhance the value - while reducing the risk - of an investment portfolio holding a policy appropriate to the portfolio.

H. A process of associating a risk tolerance with the dominant attributes of whole life, no-lapse guarantee universal life, and variable universal life produces an efficient portfolio of policies that optimize potential results within the chosen risk category.

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