WEB EXCLUSIVES

Expand the Whole Life Conversation by Telling the "Real" Story Behind Total Returns

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Someday, we'll look back at 2008 as a watershed for life insurance producers. It was then that the near collapse of the global financial markets shook up old ways of thinking about life insurance and reinforced its role as a core component in a well balanced investment portfolio.

Investors had no choice but to revise their view of participating coverage as a static safety net, a "stow-it-away-until-the-end" death benefit and little else. The reason: The cash value of whole life coverage held steady at a time when both equity and fixed income investments took a nosedive.

In short, the financial world got a very strong reminder that, even in volatile markets, whole life insurance was capable of augmenting a portfolio two ways – through its provision of a death benefit unequaled by any other investment class (and unaffected by volatile market value adjustments) and its generation of cash values that can be used to create a steady increase in asset value equal to that produced by high quality bonds.

Now, three years later, the time has come to take the argument in favor of whole life's fundamental place in financial portfolios a step further: to refine its role as the core of your clients' portfolios – guaranteed protection that simultaneously generates a return.

Honing the Message

First, producers need to sharpen their message to consumers. We must continue our efforts to clear up pervasive myths about life insurance and the way your clients choose a policy to meet their long-term goals. Take the popular "buy term and invest the rest" mantra that came into vogue in the 1990s. Scratch beneath the surface, and you see that term life might yield short-term savings but isn't really a cost effective solution over the long haul.

Another example is the thinking that clients should cash out life insurance policies when they retire. That's equally unfounded in an era when retirement seems to be pushed further into the future and life expectancy – and its related costs - keeps rising. The cash value of a whole life policy is indispensible at retirement: It can help generate funds to bolster retirement savings, pay for long-term care or more.

Second, it's just as critical that we promote life insurance coverage as an actively managed asset. Life coverage needs to be assessed regularly to ensure that clients have the right policy or mix of policies to meet their objectives, budgets and risk tolerance. A periodic review can be triggered by any number of events - a life change such as marriage or the birth of a child, a major promotion on the job accompanied by a large raise, or a shift in the financial markets and impact on one's investment portfolio.

The Numbers Don't Lie

Modern portfolio theory – the blueprint we use to manage client assets – champions diversification. Put into practice, investors' principal is divided among asset classes – traditionally cash, equities and bonds – that often react to economic conditions differently and tend to increase overall gains and cushion the risk investors ultimately shoulder.

Modern portfolio theory also validates that whole life should be the centerpiece of a real world financial strategy – one that recognizes that actual returns aren't what you gain, but what you get to keep! To demonstrate this, we rely on Thornburg Investment Management's annual study that takes 30-year historic returns in various categories of assets and then subtracts management fees, dividend taxes, capital gains taxes and inflation. The result is the "real real return" for each investment included in the study.

In the chart below, you can see how much inflation, taxes and expenses eroded each investment's nominal return – leaving each investor, in essence, with a substantially lower performance result. In fact, certain investments, such as T-bills and commodities, actually lost money for those individuals who remained invested for the full 30 years. So how does permanent life insurance compare?

Using Thornburg's approach, we used an actual participating whole life policy sold by The Guardian Life Insurance Company of America in 1985, for which full premiums were paid for 25 years. Because life insurance cash values (unlike most investments) are net of fees and taxes, the only adjustment made is for inflation, which Thornburg calculates as 3.51% for the 30-year period from 1980 through 2009. Consequently, the policy's 5.19% historic cash-on-cash return falls to 1.68% when inflation is taken in account, ranking it right in the middle of other fixed-return assets.

Value: Perception is Everything

Convincing clients that life insurance belongs in their actively managed portfolio of assets will require new thinking, on their part and yours. Our society is obsessed with getting the best deal. Consumers are fixated on costs and they don't want to have to pay more than necessary for anything, life insurance included.

That's not the right way to approach long-term life insurance ownership, however. Often what seems like a bargain holds less value upon closer inspection. Case in point: As affordable as term insurance may seem, the fact is that a policyholder is likely to pay premiums amounting to as much as 70% of the death benefit on coverage held to current U.S. life expectancy.

Coverage should be focused on replacing your client's total "human life value," a comprehensive view of his or her lifelong economic value. Of course, producers have to take into account each client's individual risk tolerance and financial situation in order to tailor the right mix of policy styles (whole life and universal life, for example) to achieve the desired balance, which can fluctuate over a lifetime.

That's why it's important to approach life insurance not as a once-in-a-lifetime purchase but as a portfolio building block that requires rigorous, ongoing management. With mutual funds, assets are reallocated based on a client's age, risk tolerance, personal circumstances and market conditions. The same should hold true for life insurance. Our aim to meet clients' needs may require us to opt for different policies and combinations of coverage.

There's no getting around the fact that the gold standard of participating whole life requires a substantial financial commitment. For those who have the luxury of choice, it's the optimal purchase. Some clients – young families, for instance – may be forced to compromise, not on the core value of life insurance or its human life value, but on the steps they can take to meet their protection needs.

In such cases, the ultimate goal should be to move to a permanent policy as soon as their resources allow, to provide them both income protection and cash value appreciation. A starting point might well be a high-quality term life plan that's convertible to permanent life within a certain period. And, typically, it is possible to make the switch later on, especially if you and they have planned for it. That's the "properly acquired" piece of life insurance as a managed asset.

Perceptions don't change overnight. When it comes to life insurance, myths can be pervasive. But the financial turmoil three years ago certainly opened investors' minds to the notion that whole life's combination of cash appreciation and death benefit make for a peerless asset. The time is right for producers to take that "uncommon knowledge" to the next level, by demonstrating to their clients the importance of holding their insurance assets to the same standards for real real returns they have for their traditional investments.

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