FA
FINANCIAL ADVISOR PUBLICATIONS
THE REGIONAL RESOURCE FOR FINANCIAL PROFESSIONALS
March 2009 VOLUME 2 NUMBER 7
$2.95

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A Conversation With Michael Fliegelman

Life Insurance:
An Asset Class For Troubled Times

Michael Fliegelman, CLU, ChFC, RFC, is co-founder and president of Innovative Planning Services of Woodbury, LI, a general agency for the Guardian Life Insurance Company of America. His 25 years in financial services include wide experience with both insurance and investment products and counseling individuals, families, businesses and not-for-profit organizations.

***FA:** Thank you for taking the time to visit with us. We selected you for this interview from the many distinguished executives we know because of your reputation as an ardent student of the life insurance industry. We commend your excellent website (www.whywholelife.com) to our readers.*

Thank you. I'll try to be helpful.

***FA:** There are variations of life insurance, but we'll focus on participating whole life since that's your passion. You say it's not being fully utilized by financial planning professionals and the public. Most financial advisors don't see life insurance as an investment class, but you apparently do.*

Absolutely. While its primary purpose is protection, whole life insurance has many features that make it an outstanding place to put your money – and one that can be the foundation of a diversified investment portfolio. Unfortunately, life insurance is not always seen this way. The risks that have been taken because of the popularization of stocks, bonds and mutual funds have devastated many people. Last year, all my accounts – my 401(k), mutual funds and deferred compensation account went down in value. But there was one asset class that went up. That was my participating whole life insurance. The cash value of all my policies went up.

***FA:** How did that happen?*

There are three vital guarantees to my whole life policy: 1) The premium will never go up, 2) there is a guaranteed death benefit and 3) there is a guaranteed cash value. They cannot go down or be changed. These three guarantees lead to many, many benefits. In addition, my insurance company paid a dividend, as it has done since 1865. This is not guaranteed until it's actually paid. Whole life insurance is an *up* asset in a down market; different from any other asset class. Cash values of participating whole life policies are book value, not market value, assets. Once a cash value increase or dividend is credited, it cannot go down since it is not subject to market or interest rate volatility.

***FA:** Your Guardian colleague in White Plains (NY), Anthony Domino, compared life insurance to a Swiss Army knife. Explain that.*

Like a Swiss Army Knife, a life insurance policy has many uses during lifetime and at death. For example:

* The cash value provides living benefits similar to bonds and CDs, but with a guaranteed minimum. This can be used to supplement retirement income or to fulfill a pressing need in the near term.
* This cash value accumulation can be accessed tax-free.
* The death benefit provides cash when it's needed the most. What's more, it is payable income tax-free and possibly estate tax-free. And the death benefit is triggered by an event that is certain, (although we don't know the exact date) not a market event.
* Death benefits paid to a named beneficiary are generally not subject to creditors of the insured, and cash values in some states are protected from the insured's creditors.
* The policy is funded with affordable periodic payments that, over time, are inherently leveraged to a capital return. And these premiums may also be funded with capital earned from other invested assets in lieu of budgeted income.
* Premiums can be waived during periods of disability if the insured purchased a waiver of premium rider. This is important. Say I'm paying $10,000 a year into a whole life policy. I have a stroke and become totally disabled at age 47. The life insurance company, with the waiver of premium rider, will pay the $10,000 premium as long as I'm disabled; cash values will continue to accrue and the policy will be entitled to receive the full, annually declared dividend. On the other hand, suppose

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I put the same $10,000 into a mutual fund. That fund company, no matter how good it is, will not put away the $10,000 for me every year. But the life insurance company will. There's no other financial product in the world that does this.

* There are the three vital guarantees I mentioned earlier.

* And now, there are policy riders that can allow part of the death benefit to be paid income tax free to the insured in the event of permanent chronic illness or terminal illness to help pay for care in a nursing home or even at home.

So, the Swiss Army knife. (See illustration.) You never know when you're going to need the corkscrew, the scissor or the knife, but when you need it, it's there.

Where else can you find all of this in one financial product?

Many Uses

1. Death benefit. Money when needed most.
2. Living benefits through growth of cash value.
3. Protection against market risk.
4. Protection against interest rate risk.
5. Protection against taxes.
6. Protection against creditors.
7. Protection against disability.
8. Protection against the cost of health care during retirement years.
9. Provides collateral.
10. Provides ability for the insured to consume and enjoy his other assets with more flexibility and peace of mind.

FA: *Life insurance agents are often accused of representing their products as solutions for everything. No matter what a client's situation or objectives, life insurance is the answer.*

Every financial advisor, whether insurance or securities-based, is biased toward the products in which he or she has specialized for an entire career. But for the client, it should not be one or the other, but both. Life insurance acts as a safety net and stabilizer of the portfolio; most often in the conservative portion of the portfolio's asset allocation. Some of the money in bonds and cash could be used to pay the premium for permanent life insurance. The cash value is an uncorrelated asset to other fixed income securities. When interest rates go up, bond values generally go down; but the cash value of the life insurance does not go down. Again, because of the 3 vital guarantees of a Whole Life Policy – plus the non-guaranteed dividend – Whole Life Policies can lower the risk in the portfolio.

FA: *How much life insurance should be in an investment portfolio?*

That depends on many factors. A business owner or real estate developer may need substantial amounts of permanent insurance to protect his estate from estate taxes, fund a buy sell obligation, or to equalize his estate among his children. A high income individual may need insurance to replace most if not all of his/her income because of a premature death. Other individuals look at the growing cash value in a policy to supplement a retirement plan, especially now as companies are cutting back on profit sharing contributions and 401(k) matches. The problem with most advice that people read in newspapers and magazines is that the advice is not for them. It's for somebody else. Everyone's trying to create these standard answers. That happens too much in media.

We as financial advisors must develop plans for clients that work under all circumstances, not just when times are good. We need more guarantees in our lives and that became crystal clear in the last eight months. The better protection we have, the more aggressive we can be with equities, real estate and other investment vehicles. The better my offensive line protects my quarterback, the more aggressive he can be in throwing the ball.

FA: *It is the cost of this protection that some see as prohibitive.*

The main reason for that, by the way, is that we too often assume we're going to have to pay the premium out of our lifestyle budget rather than considering life insurance as part of the portfolio and PAY for it with re-allocated assets form the appropriate portion of the asset allocation.

An old adage says you get what you pay for. Cash value life insurance is a long term commitment because the lifetime benefits of the policy are not realized for a

good number of years. When individuals realize this, the premium is no longer viewed as a cost, but an investment in a long term plan.

So consider this : Say there's $20 million in an estate: half in stocks and half in bonds. What happens when the individual dies? After taxes, the next generation may get only about $11.5 million because of estate taxes. But let's say the interest from the bonds was used to buy a $20 million life insurance policy. Now when the guy dies, it's a $40 million estate and the family will get approximately $23 million after taxes. In Richard Weber's whitepaper entitled *Life Insurance an Asset Class*, he concludes, "A participating whole life policy funded by the income from a municipal bond component within a larger investment portfolio was found to produce a significantly larger legacy value and a growing advantage in liquidity value over the life of the investor... [This] produced a higher retirement income than did the bond asset itself."

FA: *Advisors are looking for good returns for their clients while they're alive and they don't see getting that from life insurance.*

Let me show you an actual case that I think is dramatic, A 40-year-old man bought a million-dollar policy in 1983 and paid in annual premiums of $18,365. Now, 25 years later, with the build-up of cash value, the policy's cash value is worth $1,008,332, which is a 5.6% tax-free yield. Not a bad deal. Add to this the death benefit of $1,841,111 to protect his family and all the other benefits we discussed.

FA: *So at $18,365 per year, he paid in a total of $459,125 and got a 5.6 % return. Most advisors are looking for 8 to 12%. Suppose he would have invested that $459,125 somewhere else – like in the stock market? Suppose – if you'll pardon the expression –he bought term and invested the difference?*

First of all, even the high net worth families I work with appreciate the discipline of having cash value life insurance premium payments. Secondly, it's about balance: What happened to the people who invested entirely in equities during the "heyday" of the 1982-1999 bull market. Most of those gains were given back from 2000-2002 and most especially in the last 8 months.

But let's say this individual actually did invest the difference: But when did he buy? And when did he sell? Or did he simply buy and hold? Although the average compounded rate of return of the S&P 500 since 1923 was 10.5%, the volatility of that average ranged from a high of 46.59% to a low of minus 47.07%. You can talk all you want about 10% rates of return, but the consumer usually doesn't get that because of his propensity to sell when the market's down (fear) and buy when it's high (greed).

As for his term life insurance, how long was the term?

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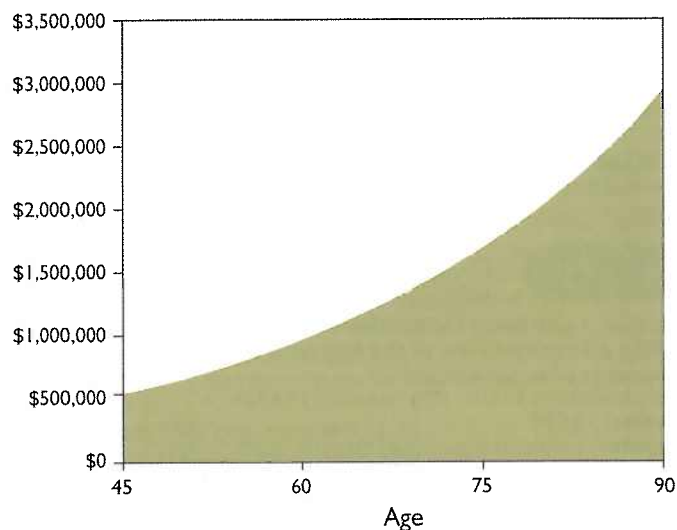
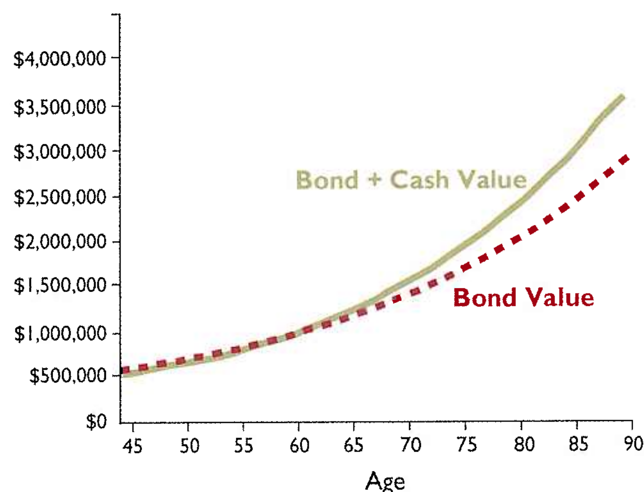
Value of Bond Component with Income Purchasing More Bonds



Asset Values of Bonds and Life Insurance



The charts evaluate growth of a $500,000 initial investment from age 45 to age 90. The first chart shows that the investment in bonds, growing at an assumed constant 4% rate of return over the years would accumulate an asset value of $2,920,588.

The second chart compares the results if the $20,000 initial bond income was used to purchase a whole life policy with the results of an all-bond option. During the first 19 years, the all-bond option produces slightly higher accumulations than the bond/cash value alternative, then the values utilizing life insurance rapidly increase, outstripping the bond value alone in the later years. This coincides with the years when an individual may want additional resources to draw upon for income, as inflation and the cost of living could have outpaced Social Security and a pension.

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If it was just 20 years, that's up now, so there is no death benefit or it becomes extremely costly to maintain. Term insurance makes sense when there is a specific period of time when you'll need the insurance and you're certain you won't need it beyond that date. But that applies to fewer people these days because we're living longer and working beyond traditional retirement age. Also, we're having children later, changing careers, starting up businesses and second families. Our financial responsibilities are not only greater, but more wide-ranging. Therefore, an increasing number of people have a lifetime need for life insurance.

FA: *Another concern about life insurance as an investment is that you don't have much in the early years; it takes a while for the cash value to build up.*

You are absolutely correct. Let's be clear that we're talking about needed life insurance purchased in the context of it being part of your investment portfolio; we don't advocate buying life insurance as an investment by itself. So the needed life insurance should be managed as an important asset, consistent with your resources.

Permanent insurance is a long term commitment. But, products today are versatile. When the insured purchases a "paid up" additions rider, he is accelerating the amount of money allocated to cash value and death benefit so that the product will perform better in the early years. Still, I agree with you. It does take time to build up cash value. And, if the insured is a smoker or not in the best of health, the cost of the death benefit increases which lowers the rate of return on the cash value.

FA: *Isn't there a limitation on these paid-up additions?*

Yes. When people catch on to something good, it invites limitations. Back in the 1980s, insurance companies were selling single premium policies that truly were investments wrapped in policies that provided minimal death benefits, but enabled the insured to enjoy the tax favored benefits of life insurance. Congress passed a law that says if too much money goes into an insurance policy it creates something called a MEC (modified endowment contract). Once a policy is a MEC, the lifetime tax benefits of withdrawals are lost. Therefore, there is a limit to how much a policy owner can pay into a policy (before it becomes a MEC).

Still, whole life paid up additions and over-funded policies on employees are commonly used by banks and other corporations. This corporate or bank-owned life insurance (COLI or BOLI) funds pensions, healthcare and other benefits; it can also strengthen the company's financial stability.

FA: *What do banks and corporations know that individual consumers and their financial advisors don't.*

If you have $10,000 sitting in some safe place paying a return of 5.6%, that's all you have. But in a life insurance policy, you have the money growing safely – as the guaranteed cash value grows free from market volatility and taxes. On top of that, you have the policy's cash values and death benefits potentially growing as any dividends are used to acquire paid-up additions. So the banks and corporations know that by having insurance on a lot of people, they're getting a better rate of return because, inevitably, people die. And this comes without exposing the corporation to risk.

FA: *Insurance companies have been hurt by the economic downturn just like everyone else. Their trade association is asking for TARP money and there is concern about the guaranteed contracts that you described. How can insurance companies make good on these promises if their own investments perform poorly?*

There are companies that have invested some of their assets in high risk vehicles and are excessively leveraged, but they're the exception, not the rule. The main point that came out of a recent Standard & Poor's insurance conference is that life insurers are showing resilience to the downturn in the economy and the credit markets. With respect to TARP money, all the ACLI (American Council of Life Insurers) is asking is that the Capital Purchase Program be extended to all life insurers, not just those which control banks or thrifts. This would encourage everyone to start investing again in the corporate bond market, which life insurers have been avoiding lately. I'm a General Agent for Guardian, which is doing very well. Guardian had a great year in 2008. Its risk management protected the company's general account with conservative portfolio management and dynamic hedging strategies. In fact, Guardian was recently upgraded by S&P and A.M. Best. And Guardian just increased its dividend scale for 2009; paying a higher dividend interest rate this year than last – which is remarkable. Most of the big life insurance companies have been around a long time and made it through many economic downturns, including the Great Depression. You should do business with a quality company that's performed in all economic climates. I should say, too, that current circumstances will accentuate the value added by well-trained and responsible insurance advisors.

FA: *What are your personal investments?*

I have both stocks and bonds along with residential and commercial real estate, including two residences. I also have a lot of permanent whole life insurance (which acts as the fixed portion of my investment portfolio) because I need to build and protect my wealth simultaneously. Like I said earlier it's the only part of my portfolio performing well right now. It's never either/or; rather it's integrated growth and protection working together over one's whole lifetime. ***FA***

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While there are many "living benefits", the life insurance policy's primary purpose is death benefit protection. Whole life insurance is not an investment product and is not regulated by the S.E.C. or FINRA.