Life Insurance: An Additional Asset Class in Difficult Times

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This article addresses two life insurance topics: It reviews the use of life insurance by family offices with at least $100 million of assets. Then it discusses the use of life insurance as a unique asset class for all high net worth families.

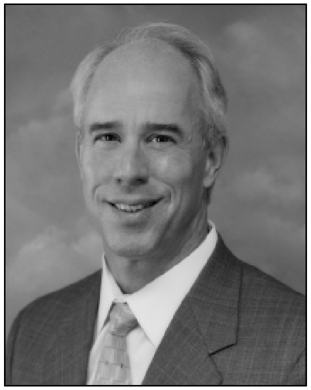
Family Offices and Life Insurance

In a 2007 *Worth* magazine survey of Family Office Exchange (FOX) members, 87 percent of respondents owned life insurance and 59 percent anticipated purchasing additional life insurance. Of the 13 percent that do not own life insurance, two-thirds say they are self insured and half believe life insurance is too expensive.

The family offices reported using insurance primarily to fund estate tax liabilities (59 percent), replenish or preserve buying power (50 percent), create liquidity (44 percent) and fund a specific bequest (15 percent). Of the respondents, 12 percent answered affirmatively to each of four other life insurance uses—equalize an estate, assure business continuity, leverage existing assets in a multi-generational trust, and fund private placement insurance. The remaining responses in the survey received single digit responses.

From the article written by Michael Brink and Tom Love, which analyzed the survey results, we can make the following observations regarding life insurance owned by family offices:

- 20 percent admit they don't understand life insurance; the actual percentage appears to be higher.
- Family offices are using life insurance as an alternative asset class.
- Family offices may not be full aware of the liability issues for trustees with trust-owned life insurance policies.
- Family offices seem to be slow to update their non-guaranteed life insurance policies.
- After issue, only one in five family offices continues to review the financial strength of insurance companies or the potential adverse impact of mergers and acquisitions.
- The majority of family offices own policies that lack the flexibility to adjust to changing objectives, circumstances and tax law.
- Although they claim a good understanding of gifting and wealth transfer strategies, two of the least understood purposes were (a) how to leverage existing assets in multi-generational planning and (b) how to use insurance as an alternative investment strategy.



R. Marshall Jones

Life Insurance as a Unique Asset Class

In 2008, we learned that, although Wall Street's next-generation of financial derivatives were designed by math geniuses, they were not understood by the individuals responsible for them. Even worse, we discovered that investment risks like credit default swaps were virtually unsupervised and lacked even the most rudimentary assurance of available reserves to pay claims.

Fortunately, the life insurance industry has almost none of the problems of Wall Street. Unfortunately, everyone has been hurt by the greed and asleep-at-the-switch mentality that drove us to the brink of financial disaster. Corporations like AIG will sell their safe and profitable life insurance company subsidiaries in order to raise cash to help solve their financial problems.

Until recently, permanent life insurance was arguably the financial industry's most complex instrument. Fortunately, due to its complexity, life insurance is highly regulated to assure there are always sufficient, safe assets to honor its guarantees. This is referred to as statutory accounting. For more than 100 years, every life insurance death benefit has been paid

All life insurance companies use statutory accounting. In addition, publicly traded insurance

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companies use GAAP accounting. It allows them to report the expected profitability of products that require reserves to back their contractual liabilities. The financial problems of 2008 forced several life insurance companies to seek capital in order to maintain GAAP accounting solvency, even though they continue to be solvent on a statutory accounting basis. GAAP problems drove down the stock prices of life insurance companies in 2008, making them attractive takeover candidates. As worldwide capital returns to normal levels, this may increase the rate of consolidation that has been occurring over the past 20 years.

With the rise of both (a) guaranteed life policies and (b) variable life policies with extended guarantees, life insurance often plays a dual role for the wealthy: It is a risk management tool—a contract to deliver cash at death—and it is an investment tool. For example:

- It is oppositely correlated to all other investments in the portfolio.
- It assures that the portfolio is properly diversified in all areas, including time of investment maturity.
- It complements estate tax reduction strategies that require many years to be successful.
- It provides additional liquidity without any potential market value adjustments.
- It allows you to retain good investments with depressed values until they return to their full value.
- It can enhance returns while reducing risk.

M. Scott Peck, Ph.D. wrote, "Life is difficult. Once we accept that, it becomes less difficult." Build a team of advisors with the integrity, expertise and experience to achieve your desired results so that your life becomes less difficult and more meaningful.

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