## AN INVESTMENT DIVERSIFICATION STRATEGY:

## The Uniqueness of 'Guaranteed Life'

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Recently, older, wealthy clients have been purchasing a special type of estate planning insurance known as "guaranteed life." This article discusses a little-known use of guaranteed life contracts—investment diversification.

Three primary features make guaranteed life the policy of choice for trustowned life insurance:

- Certain cost: The premium can be
- guaranteed to never increase.
- Guaranteed benefit: The death benefit can be structured to never decrease no matter how long you live.
- Higher investment returns: The compounded internal rate of return (IRR) at life expectancy can be significantly higher than other safe assets.

What makes guaranteed life unique? It is totally non-correlated (opposite) when compared to traditional in-

vestments. It is the only investment intended to have a lower IRR each year. If you die prematurely, the insurance acts as a hedge to replace earnings you may not have experienced in your portfolio. If you live to be 100, your other investments will have time to realize their expected value. In the early years, the death benefit provides hedge fund type returns. In the middle years, the guaranteed IRR will resemble potential stock market returns. After life expectancy, the IRR will approximate municipal bond returns.

What else? Despite its higher yields through life expectancy, the policy guarantees are not subject to stock market volatility. Also, although it has many of the characteristics of a tax-free zero coupon bond, its value is not affected by interest rate changes. Its maturity value — the death benefit — must be paid in cash whenever death occurs.

How can the IRR at life expectancy be

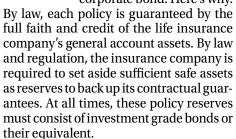
higher than other fixed income policies? The answer is two-fold.

First, many insurance companies assume, based on 100-plus years of experience, that they will not have to pay every death benefit. In other words, they expect many policyholders to cancel their policies during the insured's lifetime. When that happens, the cash value reserves will not be distributed to the policy owner. Instead, they will be used to assure the guarantees of policies that stay in force until death

Second, some policies may simply

be mispriced. Regardless, the insurance company assumes both the investment risk and the cost of insurance risk. Even if their pricing assumptions are wrong, they remain obligated to honor your policy's premium and death benefit guarantees.

How safe is the guarantee? When a guaranteed life policy is issued by a major life insurance company, you can make the argument that it is safer than an AAA corporate bond. Here's why.



What would happen to the policy if the insurance company fails? Nothing would change from the perspective of the policy owner. You would continue to pay your guaranteed premium, and the assets of the insurance company would be used to pay the death benefit. For more than 100 years, every contractual death benefit has been paid, including companies in receivership, because of the laws and regulations that require adequate reserves to back up policy guarantees.

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## GUARANTEED LIFE

A tax-free investment

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But what would happen to the assets of the insurance company if it fails? The insurance regulator would freeze the general account assets for the benefit of the policyholders. No assets would be released for creditors, bondholders or stockholders until the regulators have set aside sufficient assets as reserves to honor the contractual guarantees associated with each block of policies.

Historically, the regulators have worked with the life insurance industry to rehabilitate these insurance companies. Typically, successor insurance companies acquire large blocks of insurance policies, along with the required investment reserves, to maintain the policies' contractual guarantees.

What are the drawbacks? Guaranteed life policies are somewhat inflexible and have little or no cash value liquidity when compared to other policy types. To retain the benefits of a guaranteed premium, guaranteed death benefit contract, the policy owner must both

pay the contractual premium on a timely basis and leave any cash values in the contract.

For example, if you take out a policy loan or surrender a portion of the cash value, you may lose the guarantees described above. Although most contracts allow the owner to reinstate policy guarantees, you should assume that the reinstatement cost will be significant.

Why don't more people utilize guaranteed life policies? The problem is the life insurance label. Historically, premiums are viewed as the cost of purchasing insurance protection.

Today, with guaranteed life, a modest reallocation of assets can fund a unique tax-free investment. To use Dizzy Dean's grammatically incorrect recommendation, "Don't fail to miss it!"

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