Special Advertising Section

LIFE INSURANCE

{ September is Life Insurance Awareness Month }

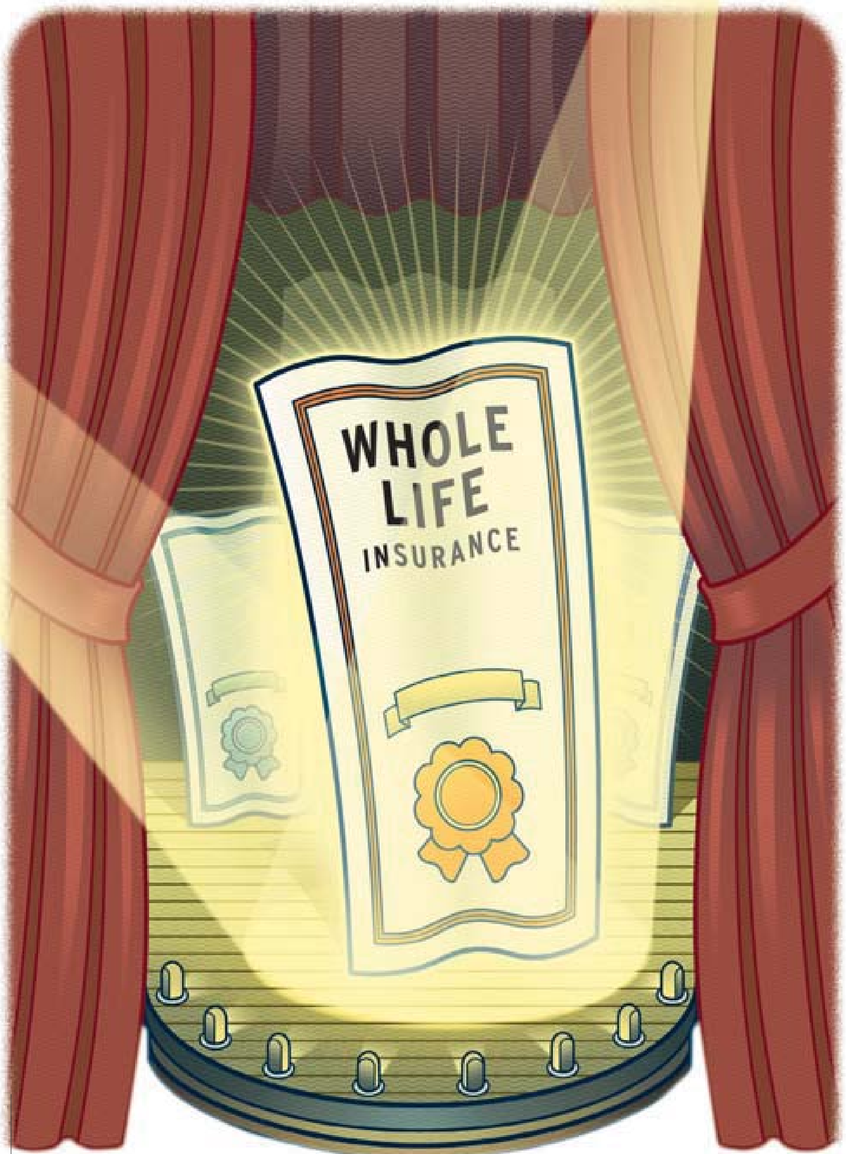
The Resurgence of Whole Life

As markets waiver, more people turn to cash value life insurance to diversify their investment portfolios

By Russ Banham

It's become an all-too-common scenario in this period of economic recession and high unemployment — people suddenly out of work with a need for cash for their living expenses, yet having investments largely tied up in equities that are underwater.

Digging into a 401(k) plan is an option, but the penalties are exorbitant and the value of stocks within it is much less than a few years ago. Selling the house is another option, but its value has also fallen. Dipping into the children's college funds seems unthinkable. An alternative that offers trouble-free recourse in the harsh realities of the recession is borrowing against a whole life insurance policy.



A Living Benefit

Whole life, or permanent life, as it is also called, is experiencing a revival of interest as a long-term investment to weather difficult economic times. Aside from the death benefit, the insurance provides a tax-deferred buildup of cash values that can be borrowed against on a tax-favorable basis, providing a ready source of capital when other sources of money are problematic or hard to come by.

"Whole life insurance is the oldest type of life insurance, and used to dominate the market until the advent of newer forms like variable life and universal life about 30 years ago," says Elaine Tumicki, corporate vice president of product research at LIMRA, a Windsor, Conn.-based insurance research firm. "With the investment climate taking a toll on these newer forms — variable life premiums, for example, are invested in the stock market — whole life is resurgent, now representing 28 percent of all new premiums, the highest it's been in a decade."

Whole life insurance provides lifelong protection, guaranteeing the policyholder that in the event of his or her death a benefit based on the stated face amount of the policy will be provided to the beneficiaries. The premium paid by the policyholder is guaranteed never to change. The cash value of the policy — the buildup of cash within the policy or the amount offered to the policyholder by the issuing insurer upon cancellation of the policy — is guaranteed to grow each year until it equals the face amount of the policy at a specified age.

It is this cash value that makes whole life insurance an important component of a diversified investment portfolio. The capital accumulated in the policy can be tapped in a pinch to pay the mortgage or the car loan. Money can also be borrowed to supplement retirement expenses, improve a home for sale, pay for college tuitions or invest in a business, among other wide-ranging scenarios. The policy loan doesn't require repayment (the amount is simply deducted from the policy payout at death), and is available irrespective of the borrower's credit history.

This "living benefit," as insurers call it, may be as valuable to a policyholder as the customary "death benefit."

Built to Borrow

"In addition to the insurance protection, whole life provides a mandatory savings that you can borrow in an emergency or to help fund college or other expenses," explains Frank Keating, president and CEO of the American Council of Life Insurers (ACLI) and a former governor of Oklahoma. "You can pay back this money or have it deducted from the death benefit when you die. The cash is readily available, although the longer you have the policy, the more cash you can borrow."

Experts say that the automatic savings from a whole life policy can be a personal emergency fund that helps you weather the financial storm," Keating says.

Two types of insurance companies sell whole life policies — mutual and stock insurers. The former is owned by policyholders and managed for their long-term financial security; the latter is owned by shareholders and managed for short-term and long-term shareholder value.

Whole life insurance is also structured to provide an additional return to the policyholder — a dividend — beyond the guaranteed return.

"The net premiums paid by the policyholder are invested in the general investment account of the life insurance company, and if the account fares better than expected, the policyholders get to participate in the excess returns over and above the guarantees," explains Daragh O'Sullivan, vice president of life product management at John Hancock Life Insurance Company.

Although the dividends are not guaranteed, O'Sullivan says. "Almost all whole life policies sold provide returns in excess of the basic guarantees. Some insurers will forego providing a dividend in return for even greater guaranteed cash values."

When a life insurer's general account achieves a substantial return in a given year, it is not uncommon for the dividend to exceed the annual premium paid (depending on the dividend option chosen).

> *"When times are tough, the cash value from a whole life policy can be a personal emergency fund that helps you weather the financial storm."*
>
> — FRANK KEATING

Stable Return

As an investment vehicle, whole life insurance falls into the conservative bucket. Insurers typically invest the premiums they collect in lower-risk fixed income instruments, which provide a stable return, typically less than five percent. The insurer guarantees this return, making whole life a reliable source of funds in an emergency — assuming the policy has been in existence long enough to build up cash value.

Even concerns about the financial solvency of an issuing carrier have been addressed, with guaranty insurance funds established in all 50 states to pay claims of bankrupt insurers that mitigate much of the potential financial exposure.

"To the extent you've bought the insurance with the aid of a knowledgeable agent and from a strong company, and you are able to maintain payment of premiums over the long term, you should have a valuable investment you can use as cash to help weather an economic crisis," says Harold Skipper, professor emeritus of risk management and insurance at Georgia State University.

Deanna Mulligan, executive vice president of individual life and disability at The Guardian Life Insurance Company of America, also sees whole life as a safe harbor during an economic storm. "We hear from our policyholders that their whole life statement is the only financial statement they look forward to opening these days."

Different Options

Still, whole life insurance isn't for everybody. Its higher annual cost deters some, who may opt for less-pricey term insurance, which provides a comparable death benefit but does not include a cash value component that can be borrowed against. Once the specified term or time length of the policy has elapsed, the death benefit vanishes.

Buying another term policy after the first has expired can be costly, depending on the applicant's age. Consequently, many policyholders 60 years of age and older whose term policies have terminated typically pass on buying another one. "At age 65 the cost of term insurance is exorbitant because of the greater risk of dying," explains Michael Book, a life insurance general agent and managing partner at Fifth Avenue Financial in New York.

With term insurance, if the policyholder dies during the policy term, the beneficiaries receive the death benefit. If the policyholder survives and the policy

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Illustrations by Peter and Maria Hoey

Resurgence

Continued

expires, there is no financial return to the buyer and the insurance company comes out ahead.

Nevertheless, the guaranteed death benefit and the low monthly premiums of term insurance make it an attractive choice for many people, particularly those just starting out.

Financial Safety Net

Melissa Millan, senior vice president at Springfield, Mass.-based insurer MassMutual Financial Group, says whole life insurance gives policyholders access to their own money to address the vicissitudes of life — the death of a loved one, a sudden change in employment or a significant loss in the value of other investments.

"Policyholders can borrow against the cash value of their policies to provide a financial safety net should they need it. Only in cases of dire need should they consider surrendering their policies, as they'd lose many benefits including the main one — the death benefit," she notes.

Its flexibility and broad range of uses, in both good times and bad, makes whole life increasingly popular as a strategic investment vehicle.

Death and Taxes: For one, the U.S. Government permits the death benefit to be income tax-free. Uncle Sam also sanctions treating the cash values that build up inside the policy on a tax-deferred basis, and allows policyholders to borrow from the cash value of a policy on a tax-favored basis. "You can draw out this money without tax consequences depending on the policy structure," Millan says.

Estate Planning: Whole life policies offer the prospect of a cash disbursement that can be directed towards paying estate and inheritance taxes, allowing one's heirs to avoid having to liquidate the estate at a time when assets may be depressed.

For example, say you purchased a $10 million policy and it has reached maturity. You can direct the proceeds from the policy into an irrevocable trust, which for tax purposes resides outside the estate. If, after you die, the IRS asserts a $7 million estate tax liability, your heirs could liquidate your assets to pay the taxes, but if those assets are underperforming, they would be loath to cash them in. Instead, the irrevocable trust could write a check to the IRS for the $7 million tax bill, preserving other assets for a rebound in value — and preserving the maximum value of the estate for your heirs.

Liquidity: Access immediate cash when the bulk of investments may be in securities, real estate or other illiquid vehicles. Again, by leveraging the cash value of a whole life policy, investors can keep the value of these assets intact.

Opportunity Knocks: Knowing there is a pot at the end of the rainbow — the cash value built up over years of paying premiums — a policyholder working with a financial adviser may wish to pursue higher risk/higher yield investments. When opportunities arise to benefit from an upswing in a particular investment class like stocks, cash can be borrowed from the policy to invest in these potentially higher-income assets.

Retirement Flexibility: Since a whole life insurance policy often provides returns beyond the guaranteed cash value, the policyholder can use this additional sum at retirement while maintaining the full value of the policy. "The guaranteed cash value of a whole life policy is actually the worst-case scenario," O'Sullivan notes. "Typically, the policy will provide a greater cash value that can be cashed in, borrowed against, or the entire policy can be converted to another product like an annuity."

Keating recently converted the full value of one of his whole life policies into an annuity, he says, "to provide a regular income stream when I retire."

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>
> — MELISSA MILLAN

Small Business Solution: For growing companies, whole life delivers an array of advantages. For starters, many enterprises buy whole life insurance if the company is owned jointly. Each partner owns and is the beneficiary of a policy on the other's life. In the event one of the partners dies, the cash can then be used to buy the deceased partner's share in the business from his or her estate.

Insurance carriers and agents regularly advise clients to work with their tax and legal advisers to structure the policy ownership and beneficiary designations appropriate to the individual situation.

"A major reason for a business failing is the death of an owner or key employee," Mulligan notes. "The solution is a buy-sell agreement that stipulates the price to buy out the shares of a deceased business owner, and then to informally fund it with a whole life insurance policy. You don't want to have to liquidate other assets to make the purchase, especially in a down market."

Businesses also give whole life insurance to key executives as an employee benefit. "If they leave the company before a certain date, they lose access to the policy," explains Timothy Flanagan, a life insurance general agent and president of Hinrichs Flanagan Financial in Charlotte, N.C.

"With each passing year, you're providing a greater incentive for employees to stick around, as they watch the cash value of their policies continue to grow. Some insurers will even allow the insurance to be transferred to another executive if the original policyholder decides to terminate employment," notes Flanagan.

Whole life insurance provides access to needed cash when a small business owner does not want to liquidate equities, real estate or other illiquid instruments to obtain it. Flanagan points out that "Sam Walton, Walt Disney and J.C. Penney all leveraged the value of their life insurance policies as a financing vehicle to assist their business plans."

An added small business bonus: The cash value of a whole life policy is protected in many states from bankruptcy and personal liability lawsuits.

Ideal for Diversification

Although it is more expensive than term life insurance, whole life insurance is permanent, lasting through a person's lifetime. Since premiums must be paid regularly, the insurance is a form of forced savings. In return, the policy provides a guaranteed financial return, albeit at a conservative rate, that argues for whole life as a key element in diversified investment planning.

"The current economic crisis has highlighted the importance of having an appropriately diversified investment portfolio, and traditional whole life insurance fits into such a portfolio," says Professor Skipper. "Many people fail to grasp the importance of whole life, but it's in a downturn when you really see its value."

Russ Banham is a veteran business journalist. His articles have appeared in Forbes, The Economist, CFO, *and* U.S. News & World Report. *His latest book is "The Fight for Fairfax."*

Protecting the Most Important Asset — Your Children

One couple uses whole life to care for special needs

Ann and David MacLaren discovered a critical purpose for whole life insurance — the care of their children. "We have four children, three of whom have special needs," explains Ann MacLaren. "Our twin 15 year-old boys have autism and we have a daughter from China who is eight and legally blind from toxoplasmosis, a parasitic disease common in the developing world. We were concerned about their ongoing needs in the event we're not here to take care of them."

The MacLarens, from Fortville, Ind., turned to their financial adviser and an estate attorney to help address their concerns. They were counseled to purchase a whole life insurance policy that provided traditional benefits like permanent coverage and built-up cash value. The proceeds from the policy after both David's and Ann's deaths would flow into a Special Needs Trust.

While the MacLarens have other investments, including stocks, a 401(k) plan and even term insurance, David MacLaren comments that "term life doesn't last forever, and the last couple years taught us that you can't rely on the stock market for your enduring needs. We want to ensure that our children have access to financial resources that are stable and will build over the long term to fund the trust."

The MacLarens purchased the whole life insurance last year, which did not come cheap, David concedes. Yet, he says, the timing was right: Had he invested the money instead in stocks or bonds, the overall value would be much less today. "We can't know and will never know just how independent our kids will be or the judgment calls they'll make," says Ann. "Having the insurance and knowing the proceeds will go into a trust for their benefit has given us great peace of mind."

Finding a Missing Life Insurance Policy

If you suspect your loved one had a policy, but cannot locate it, you may want to conduct your own search using the steps provided below. As an alternative, MIB, an insurance membership corporation, offers a policy locater service for a fee.

For more information about this service, visit MIB's Web site: www.mibsolutions.com/lost-life-insurance/.

- Check your loved one's papers and address and telephone books to look for life insurance policies and the names of insurance agents. Contact every insurance company with which they had a policy, even if you're not sure the policy is still in force.
- Check with the employee benefits office at their latest and previous places of employment. Or, check with the union welfare office.
- Check bank books and canceled checks for the last few years to see if any checks may have been written to pay life insurance premiums.
- Check the mail for one year after death for premium notices, which are usually sent annually. If a policy has been paid up, there will not be any notice of premium payments due. However, the company may still send an annual notice regarding the status of the policy or it may pay or send notice of a dividend.
- Review your loved one's income tax returns for the past two years. Look for interest income from and interest expenses paid to life insurance companies. Life insurance companies pay interest on accumulations on permanent policies and charge interest on policy loans.
- Check with the state's unclaimed property office to see if any unclaimed money from life insurance policies may have been turned over to the state. If, after a number of years, an insurance company holding the unclaimed money cannot find the rightful owner, it turns the money over to the state.
- Of course, you may wish to contact life insurance companies directly to see if a policy exists. Each state insurance department has a listing of life insurance companies licensed to do business in its state.

Source: ACLI

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Customizing Coverage with Policy Riders

Life insurance can be enhanced through the purchase of policy riders, which provide additional benefits and/or expanded coverages. Many life insurers offer a wide selection of riders, each addressing a unique personal financial need.

A common rider is the Accidental Death Benefit Rider, which provides the beneficiary an additional financial amount if the named insured dies as a result of an accident. In many policies, this amount typically is doubled, hence the term "Double Indemnity." The rider addresses the risk of someone young, healthy and otherwise expected to live a long time who dies suddenly, causing unanticipated financial stress for his or her family.

Another rider that meets a special need is the Accelerated Death Benefit Rider, which gives terminally ill policyholders the opportunity to cash in part of the death benefit while still alive to pay for long-term medical care or confinement in a nursing home. Similar needs are met by purchasing a Long-Term Care Rider, which provides cash to be used toward nursing home care or home care.

Other common riders include the Guaranteed Insurability Rider and the Waiver of Premium Rider. The former permits the policyholder to increase the financial limits of the insurance at specified policy intervals, without the need to prove insurability. The latter waives the payment of future premiums if the policyholder becomes permanently disabled. Broader protections are afforded by buying a Disability Income Rider, which provides a stated sum per month if the insured becomes totally disabled and unable to earn an income.

Many other riders are available, and insurers regularly invent new ones. A word of caution: Riders are not standard fare; their contracted terms, conditions and cost vary from one insurer to the next. It is important to discuss the different types of riders and their respective features with an insurance agent or financial adviser.

— R.B.

COMPARING LIFE INSURANCE POLICIES

Life insurance has come a long way from one-size-fits-all. Whole life insurance, the granddaddy of all life insurance products, is just one type of life insurance offering. In recent decades, newer forms of life insurance have emerged, such as term life, variable life and universal life.

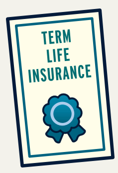
The new policies were predicated on meeting the different needs of individuals — term life, for instance, offers affordable premiums, albeit the insurance expires after the term has elapsed. Newer variable life and universal life policies were created to provide the opportunity for policyholders to potentially achieve greater investment return than historically offered by whole life policies.

A decline in the stock market can affect the investment value of both variable and universal life products, which invest a much greater portion of policyholder premiums in equities (variable life) or are linked to prevailing interest rates (universal life).

Insurers of whole life policies, on the other hand, absorb the investment risk and typically invest policyholder premiums in primarily low-risk, stable, fixed income instruments.

Insurer-paid dividends, though not guaranteed, may provide additional financial value. What is guaranteed is the cash value of the policy.

Where all four types of life insurance policies converge to share value is the death benefit. Various tax benefits are also provided, though it is best to discuss these with a certified financial adviser.



- >> Income tax-free death benefit
- >> Term period
- >> Fixed premiums
- >> No investment risk

- >> Income tax-free death benefit
- >> Coverage period based on premiums paid
- >> Has cash or account value
- >> Can borrow against cash value
- >> Flexible premiums
- >> Can use cash value to pay premiums
- >> Insurer absorbs minimum guarantee risk; policyholder absorbs risk above that

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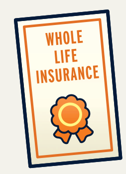

- >> Income tax-free death benefit
- >> Lifetime coverage
- >> Has cash value
- >> Can borrow against cash value
- >> Fixed premium with some flexibility
- >> Can use cash value to pay premiums
- >> Insurer will absorb any investment risk

SOURCE: ACLI