

# The Power of Guarantees: Participating Whole Life vs. Indexed Universal Life

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It's as American as apple pie to look for a great deal. There's little that thrills quite so much as achieving a bargain. It's no surprise, then that insurers such as *Progressive* have seen substantial increases in market share for its focus on getting a great price (and a smile from *Flo*, Progressive's TV spokesperson).

When it comes to life insurance, the debate over *buy term and invest the difference* is almost as old as this 250-year-old industry. The *buy term* concept is that we should be able to invest better than an insurance company – but the essence of the message is that term premiums are *cheap* (at least initially), and *cheap is good*.

Aristotle might disagree. In a somewhat modernized version of one of the philosopher's 2500-year-old observations of human nature, he mused that "... we're drawn to the attractive impossibility rather than the less attractive *probability*." Who would have guessed that non-guaranteed life insurance premiums were an active part of business in Ancient Greece?!

With all of the modern and even high-tech variations on life insurance available to today's consumers, there are still just two design options for lifetime (no matter how long you live) coverage: 1) based on guarantees and 2) based on a projection of current assumptions that may improve – or may not. Indexed Universal Life (IUL) falls into this latter category.

But buying anything based on *price* alone is to ignore other important features that should be considered before honing in on the right type of car, computer, or insurance policy. When it comes to life insurance, for example: what's your inherent financial risk tolerance? Are you Conservative? Balanced? Aggressive? And how much do you want to be involved in managing your policy over a lifetime? Do you want to have the responsibility for choosing how your premium dollars are invested, or let that 150-year-old institution do it?<sup>1</sup> Do you want to have access to cash values during your lifetime? Should death benefits have an opportunity to naturally increase over time, helping to compensate for the inflation-inspired devaluation of a fixed benefit over many years?

These are just a few of the questions that should be evaluated when the seeker of lifetime protection considers the different types of insurance to reflect her or his love

and responsibility for the financial well-being of a family, business or charity in the event of premature death.

## Chart I - Traditional Life Insurance Policy Design

### Guaranteed Design<sup>2</sup>

Risk Statement: I don't want any risk or management obligation for this asset.

### Current Assumption Design<sup>2</sup>

Risk Statement: I'm willing to accept some risk and management obligation for the advantage of premium payment flexibility.

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Whole Life

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Universal Life

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Term (for a specific period)

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Indexed Universal Life

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Guaranteed Death Benefit

## Apples and Oranges – or – Bananas and Socket Wrenches?

Comparing different life insurance policy *styles* can be tricky, especially when there is a significant difference in guarantees. A participating Whole Life policy will guarantee its \$10,325 premium for the life of a very healthy 37-year-old. An IUL policy has no stipulated or guaranteed premium, but its illustration may suggest a bargain-appearing planned premium of \$5,000.<sup>3</sup>

On the face of it, it would be tempting to choose between these alternatives based on price. After all, no one wants to pay more for *anything* than they have to – and that's probably just as true when it comes to paying for life insurance. But as already described, price alone ignores other factors that are important to most people, including;

- understanding the full scope of self-assumed risk inherent in a lowest-price calculated planned premium at high assumed long-term rates of return,
- the degree to which asset management responsibilities are or are not acceptable,
- and reliance on a projection of assumptions that by definition *will* change over time.

To at least have a reasonable comparison of product choices, Chart 2 displays both the guaranteed cash value and projected cash value (with the current dividend scale buying paid-up additions of life insurance) generated by payment of the guaranteed premium of \$10,325 for

\$1 million of a Participating Whole Life insurance on a healthy 37-year-old hypothetical insured. Chart 3 depicts the results of paying the same \$10,325 into a generic IUL for the same age/rate class.<sup>4</sup>

Chart 2 <sup>5,*</sup> Whole Life			Chart 3 <sup>5,*</sup> Indexed Universal Life		
Year	Guaranteed Policy CV	Total CV Current Dividend Scale – Paid-up Additions <sup>6</sup>	Non-Guar. CV - 0% <sup>7</sup>	Non-Guar. CV - Avg. <sup>8</sup>	Non-Guar. CV-High <sup>9</sup>
10	\$89,540	\$96,398	\$72,611	\$101,540	\$95,687
20	\$235,505	\$294,464	\$136,457	\$279,006	\$229,932
30	\$406,395	\$625,902	\$176,505	\$539,118	\$562,074
40	\$592,175	\$1,154,196	\$139,429	\$891,372	\$1,095,578
50	\$759,855	\$1,955,793	\$0	\$1,451,666	\$2,397,581
53*	\$809,520	\$2,351,316	\$0	\$1,841,489	\$2,733,932

6 – Based on the 2013 Dividend Scale. Dividends aren't guaranteed. They are declared annually by Guardian's Board of Directors.

7 – IUL hypothetical results with current expenses and 0% credited return in all years (comparable to a "guarantees only" whole life with no dividends assumed).

8 – IUL hypothetical end result for the mid-point Monte Carlo distribution of returns within 1000 hypothetically generated results.

9 – IUL hypothetical end result for the mid-high Monte Carlo distribution of returns within 1000 hypothetically generated results.

"Aha!" you think; "That 53-year 'average' of the hypothetical Monte Carlo summary begins to look a lot better than the current dividend scale example of the whole life *by the 50th year!* Surely that must be the way to go!" And while from a long-term hypothetical perspective the logic could make a certain amount of sense, we would also have to acknowledge that a projected result 50 years from now is an awfully long time from which to draw an inference of lifelong superiority. Further, it's important to understand the nature of a whole life policy's cash value increase from one year to the next – versus the way any universal life cash value is accumulated.

**The disappointment of the failure of a non-guaranteed life insurance policy to pay its death benefit remains long after the sweetness of its low premium is forgotten**

The participating Whole Life policy underlying this discussion has a guaranteed cash value of \$89,540 at the end of the 10th year without any consideration of dividends. Upon payment of the next \$10,325 premium, the cash value will increase by \$13,065 ... *guaranteed*. When the current dividend scale is considered, that eleventh-year payment will create an increase of cash value by \$15,428. Further, while dividends are not guaranteed until paid, once they *are* paid, the value of the dividend as reflected in an election to add *paid-up additions* of death benefit and cash value – similarly becomes a part of the

guaranteed structure of the policy. **Cash values of a whole life policy can never regress**, regardless of external market conditions.

In any form of Current Assumption Universal Life insurance, however, the cash value is *always* subject to downward pressure; there is never a "locked-in" value. This is the case when expenses in any given year exceed account value credits, and especially in the case of a universal life policy with underlying volatile elements. This will be the case with the "ups" and "downs" reflected in the hypothetical example of a series of "0%" returns in an IUL which, after considering policy expenses, may result in the policy's inability to "carry" itself all the way to the death of the insured.

\* The end of the 53rd year for a healthy 37-year old represents the peer group's average life expectancy – in which half of the original group has died and half is still alive.

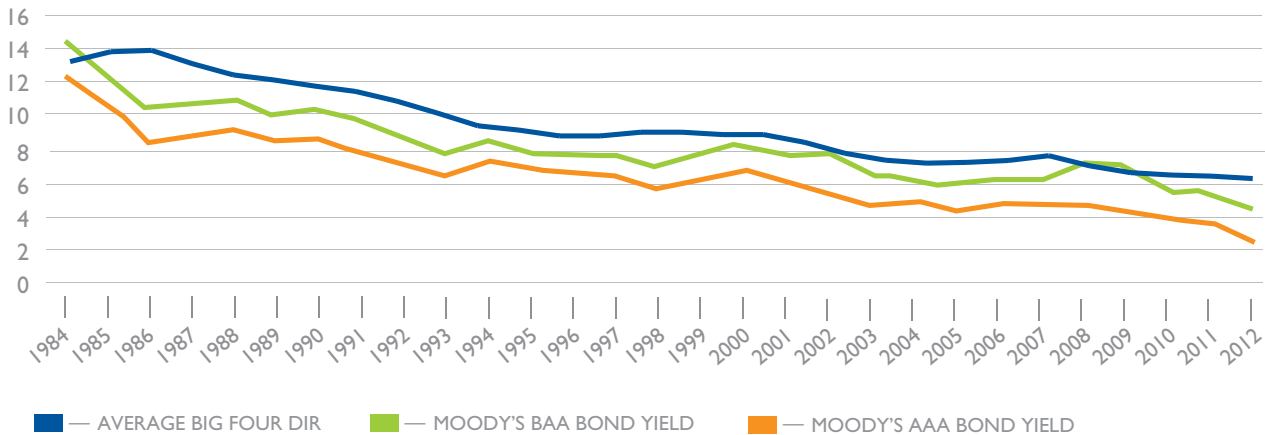
The example shown here is based on a hypothetical policy not available for sale, using male and female blended values. A full illustration, showing both guaranteed and non-guaranteed values, must be provided by a Guardian representative to individuals applying for any Guardian whole life insurance policy.

An additional issue in response to “What kind of lifetime life insurance policy will be in my best long-term interest?” is a consideration of appropriate asset classes within an individual’s total net worth. Most of us have fixed-return components (e.g., Certificates of Deposit, bonds, income annuities) and equity components (e.g., mutual funds and stocks). Participating whole life reserves are predominantly fixed-income based, and the index credit of IUL is based on equities. One is not better than another, but they *are*

apples and oranges. Consumers will want to consider their risk tolerance (which leads to choosing proportions of the different asset classes that are appropriate to that risk tolerance) before they pick a style of mutual fund – or a style of lifetime-intended life insurance.

Chart 4 demonstrates how the historic dividend scales of major mutual life insurers have tracked very closely with the returns of high investment-grade fixed-income asset classes.

**Chart 4 30-Year Comparison of the “Big Four” Mutual Life Insurance Companies Average Dividend Interest Rate (DIR) Versus Moody’s AAA and BAA Seasoned Bond Yield**



The Guardian dividend interest is graphed with a one-year lag because it is based upon the prior year’s investment results. The four major mutual life insurance companies include Northwestern Mutual, New York Life, MassMutual, and Guardian. Source: U.S. Federal Reserve

### What’s best for you?

For those with sufficient resources to consider whole life for its valuable guarantees and accessible cash value over the intermediate to long-term, there is great appeal in the concept of *locked-in* guaranteed values. This is especially true when considering the desirability of guaranteed elements as a complement to most financial portfolios.



This piece was created with the help of Richard M. Weber, MBA, CLU®, AEP (Distinguished). Mr. Weber is Managing Member of Ethical Edge Insurance Solutions, LLC, and is the 2012–2013 President of the 14,000-member Society of Financial Service Professionals. With Mr. Weber's 45 years of experience in sales, training, product design, senior management and compliance, his firm provides training and consulting services that help empower life insurance agents, financial planners, advisors and their clients to explore and view life insurance in the broader context of financial planning.

**Please note:** Guardian, its subsidiaries, agents or employees do not give tax or legal advice. You should consult your tax or legal advisor regarding your individual situation.

Whole Life Insurance base guaranteed cash values may not be available in the first two policy years. In addition, dividends, which are not guaranteed, may not be paid in the first two policy years. Whole life cash accumulation should be considered for its long term values.

<sup>1</sup> In "Revenge of the Mutuals," Moody's declared in this Aug. 2009 article that mutual life insurers "... typically have the ability and willingness to undertake a longer-term focus and orientation than do stock companies, which labor under both the constraints and public scrutiny of meeting shorter-term financial performance objectives. Most mutual companies are better able to manage and invest for the longer term needs of their primary constituents, which include policyholders and distributors."

<sup>2</sup> All life insurance guarantees are subject to the timely payment of all required premiums by the insured and the claims paying ability of the issuing insurance company.

<sup>3</sup> Based on a projection of current expense factors and an assumption of an average 8% "return" for a 1-year point-to-point return on an S&P 500 Index (0% guaranteed minimum; 10% CAP with 100% participation). This index is most often calculated without the dividends of the underlying 500 large-cap stocks included in the S&P 500.

<sup>4</sup> 1-year point-to-point return on an S&P500™ Index without dividends (0% guaranteed minimum; 10% CAP with 100% participation).

<sup>5</sup> **These are hypothetical whole life and indexed universal life illustrations and they are not representative of an actual participating whole life or an index universal life insurance policies.** These hypothetical illustrations are intended to show, in general terms, how a typical participating whole life insurance and indexed universal life policies might work. If purchase of a Guardian whole life insurance policy or an indexed universal policy is being considered, a full illustration with guaranteed values and other important information must be provided.



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