A life insurance resource for individuals and families

Your path to a stronger financial future

Uncovering the uncommon knowledge about life insurance

Based on research conducted by Richard M. Weber, MBA, CLU, AEP, and Christopher Hause, FSA, MAAA, in two white papers: *Life Insurance as an Asset Class: A Value-Added Component of an Asset Allocation (Volume 1) and Life Insurance as an Asset Class: Managing A Valuable Asset (Volume 2).**

The authors recommend that the ideal use of the information in this Consumer Guide is to help individuals bring into focus their objectives, issues, and considerations regarding life insurance. The objective is to give you the ability to not only ask questions relevant to your situation, but to be able to receive the answer from a qualified insurance professional in a way that helps you make decisions that are in your best interest.

*White papers by Richard M. Weber, MBA, CLU, AEP, and Christopher Hause, FSA, MAAA can be found on https://ethicaledgeconsulting.com/

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Do you need insurance for your entire life?

Can you rely on what you hear in the media?

Is buying term and investing the difference *really* the right choice?

Life Insurance as an Asset Class (published January 2008) and *Managing a Valuable Asset* (published January 2011) are two independent research papers on which this Consumer Guide is based. These objective papers attempted to answer some essential questions in different ways so that the reader can discover both a style of life insurance policy and a resolution of the inherent conflict over price versus value that makes sense to him or her. This Consumer Guide will delve into some of the Uncommon Knowledge aspects about life insurance that emerged from that research.

The papers were written by Richard M. Weber, MBA, CLU, AEP, and Christopher Hause, FSA, MAAA, both of whom are independent industry experts with more than 90 years of combined experience. Their focus was to view life insurance issues from the consumer's perspective — as well as address the considerations of financial professionals who don't generally deal with life insurance issues. This change in focus is both refreshing ("they're not trying to sell me anything!"), logical, and informative — and has been used for the last several years as a valuable forum for discussion among associates of The Guardian Life Insurance Company of America ("Guardian"), accountants, attorneys, other financial professionals and clients.

Both research papers (hereinafter referred to as the "Studies") are available upon request from the authors via their own third-party website, EthicalEdgeConsulting.com, and as appropriate, we'll refer to those volumes in this Consumer Guide. Please note that neither Guardian nor its affiliates recommend or confirm the content on the author's third-party website.

Section 1

An introduction to Life Insurance as an Asset Class

Ask yourself:
"What's important to me...about life insurance?"

The purpose of this Consumer Guide is to get beyond the mountain of data and opinion — and differentiate between truth and fiction — about life insurance. Life insurance is often referred to as a foundational asset that provides both death and living benefits — something that the other layers of a financial strategy rest upon. To academics, it's about risk management. To the rest of us, it's about our families (extended and otherwise), our businesses, and our charitable interests — all of which depend on us for financial support.

The financial strategy of *Life Insurance as an Asset Class* is an approach to help people protect their lives by creating a diversified overall financial portfolio. As careers flourish and resources allow for personal investment and a long-term financial strategy, life insurance products, such as participating whole life, can potentially serve as an important part of a person's or business's overall financial portfolio — complementing existing fixed-income assets that help to moderate risk and volatility in a traditional asset mix.

It's also important to give the reader a context for making decisions that are in their best interest. **Nothing contained in this Consumer Guide should be construed as *advice*, but rather information** that will not only allow you to ask good questions of a financial professional about your own situation — but also to enable you to participate meaningfully in their answers.

The best question any of us can start with when it comes to exploring life insurance issues is: "What's important to me... about life insurance?" That can be a very revealing first step in exploring the consequential questions of:

- Do I really need life insurance? And if so, *how much?*
- If I need it and we've put a number on it — of course my immediate next question is, "What will this *cost* me?!"
- Naturally, "What will this cost me?" begs the question, "What kind of policy is in my best interest — and to what extent should my natural attention on price be refocused on *value?*"

Section 2

Life insurance fundamentals

"I'm not sure I need life insurance — but if I do: how much? And what will it cost?"

Chart 1:

Financial Underwriting Guidelines for Income Replacement	
Age	**Maximum Life Insurance**
20-29	30x income
30-39	20x income
40-49	15x income
50-59	10x income
60+	5x income

Chart 1 is based on carrier experience and is a blend of top reinsurance company guidelines.

How much life insurance is right for me?

The primary reason to purchase life insurance is to replace the loss of income needed to support the survivors' lifestyle after the death of the insured. But how do we determine how much life insurance is enough? There are many different philosophies and formulas that can be applied, but the two most common approaches are Capital Needs Analysis (CNA) and Human Life Value (HLV).

Capital needs analysis budgets for current and anticipated family expenses, and takes into account other income sources as well as projections on how much essential expenses, such as health care, could cost in the future. The analysis tallies expenses, including a factor for inflation; capitalizes those future expenses by calculating the lump-sum present value using a conservative rate of return; and then offsets that by total existing assets. Ultimately, the net number produced reflects the amount of life insurance believed to be needed to support the survivors.

Human life value evaluates the economic life of the decedent — the monetary total of all that he or she would have produced and accumulated in a lifetime. Thus, this method reflects earnings potential and is not based on living expenses. It is similar to the formulas used to calculate and claim damages under a wrongful death lawsuit, the theory being that the survivors are entitled to the economic value of what the deceased *would have produced* during his or her lifetime. For example, a 39-year-old earning $100,000 per year and working to age 59 might earn a total of $2 million.

An annual study by LIMRA International (a life insurance market research industry association) and Life Happens, a nonprofit organization, measures the attitudes and behaviors of American consumers toward financial products — particularly life insurance. With respect to the potential loss of the primary wage earner, in the most recent survey, one in three households indicated that they would immediately have trouble funding everyday living expenses if the primary breadwinner were to pass away. This includes one in four households with life insurance already in place, and one in two households without life insurance.[1]

While some financial professionals recommend that life insurance coverage be sufficient to replace 7-10 years of the insured's income, this is often too generalized and insufficient in total value, especially for a young family. For example, Human Life Values at different ages can be estimated from the simple underwriting guidelines (shown on the right) frequently used by life insurance companies to determine the proper amount of coverage. *(See Chapter 1 of the first and second Volumes.)*

[1] 2016 Insurance Barometer Study, LIMRA and Life Happens, April 2016

Section 2 (continued)

What should it cost?

The Studies' authors acknowledge that the consumer's concern about the cost of life insurance immediately follows the determination of the *amount* of life insurance needed to fulfill the insured's intentions. Life insurance costs are based on life expectancy — not so much *your* life expectancy (we don't know when that will be!) — but of you as a member of a very large "pool" of individuals with the same age, gender, and general health. From the probability statistics based on millions of individuals in such pools, a premium amount can be calculated. While complicated to explain in technical language, we know that for a large group (one million) of hypothetical 35-year-old healthy females, there's only a slight chance of dying *this year,* and you'd therefore expect to pay an insurance cost relative to that small chance (plus a bit more after adding other expenses and margins to be insured). As you age, you progressively have a higher chance of death, which also typically causes insurance costs to increase because of that added risk passed on to the insurance company. The bottom line is that as we get older, this year's chance of death is higher than last year's and life insurance pricing takes that into account. *(See Volume 1, Chapter 2 for more detail.)*

But the *real* answer to the question — "What should it cost?" — involves a much more complicated process, and it starts with a few more questions:

- How long will you need and use life insurance for your financial portfolio and estate planning needs, not to mention for the fundamental protection of your family (or business and charity, etc.)?

And

- What are your resources with respect to paying for and supporting the life insurance policy that would be indicated by your answer above?

Term life insurance

Term life insurance is widely known as the simplest form of life insurance, and the previous example of the 35-year-old healthy female reflects the pricing of term insurance. Responding to the question about "How long will I need it?," Term insurance is typically purchased for short-term financial protection, although some longer durations are available. For term insurance purchased for a specified number of years, the initial premium is often guaranteed and level, reflecting an average of the next 5-30 years of otherwise annually increasing protection costs. However, once the initial "term" of years has passed, annual premiums will escalate substantially and rapidly, which often makes this type of insurance unaffordable for renewal after the initial period. The following also impacts the calculation of term insurance premiums:

- Mortality costs for expenses, reserves to pay future claims, and profit margins affect gross premiums.
- If the issuing insurance company has many "preferred" rating classes, those in merely "good" health will pay more for term insurance than if there were fewer preferred classes.

As the authors' Studies demonstrate with mathematical clarity, term life insurance is neither designed nor actuarially capable of providing protection to and beyond life. Lifetime coverage requires different styles of life insurance types designed for that purpose (the subject of the next section of this Consumer Guide), but it's still important to point out that there are key uses for term insurance, including:

- Initially helping to protect a family (or business) from the loss of a "breadwinner" (with a tight budget and looking to acquire as much insurance as is needed and can be afforded);
- Securing loans;
- Satisfying a divorce or alimony agreement;
- Insuring a short-term business obligation; and
- Having the ability to convert to permanent life insurance, while maintaining the same rating class.

The Studies elaborate on the value and predicaments of depending totally on term life insurance for a family's protection needs — especially its long-term needs — which can be found in Chapter 1 of Volume 1. And, in fact, there can be a string of relatively short-term needs that — by following upon each other — result in a longer-term need than term life insurance is designed for.

Section 2 (continued)

Addressing changes in your life

An important step in purchasing life insurance is to assess, as closely as possible, how needs may change during a lifetime. This helps determine the type of insurance best tailored to suit the needs and desires of the consumer, and allows for flexibility in planning for the future, especially if those needs occur one after another.

While most families purchase life insurance for protection against the sudden loss of their breadwinners' income, other uses of life insurance may include establishing special needs trusts for certain family members; using the cash value of a policy for special uses, such as helping to fund college; or even using policy cash values to provide supplemental amounts of retirement cash flow.[2] In addition to providing important financial protection for the family, a common long-term use for life insurance is to provide liquidity to assist with the payment of estate and other taxes, bequests, liabilities, and liquidity losses for those who are affected by such transfer costs.

If term life insurance should ideally be focused on well-defined, relatively short periods of time, how then do we provide for longer periods, or indeed, for a lifetime of coverage, no matter how long the "lifetime" happens to last? The answer is through various types of insurance policies that initially collect more premium than is necessary to cover this year's probability of death — and which take the excess and invest it as a reserve for those later years when the probabilities of death would otherwise dictate a prohibitively expensive term insurance premium. This describes permanent insurance (designed to last for a lifetime, no matter how long that lifetime) or cash value insurance (created for the accumulation of reserves for the eventual payment of a death benefit, and which are available as a resource to the policy owner as a living benefit).

There's 'term' insurance and there's 'perm' insurance

In a discussion about cash value life insurance, the authors point out that one essential difference between longer periods of term life — for example, a 20-year term policy — and a permanent policy is that the reserve for the term insurance is typically not accessible to the policyholder, whereas the reserve in a permanent policy (represented by the cash value) *is* available to the policyholder. Additionally, the longer the guarantee period of a term insurance policy (e.g., 20 to 30 years), the funding requirement (that is, the premium) becomes more like that of a permanent policy, but there still is no cash value — i.e., living benefits — with term insurance.

These *living benefits* of life insurance — which represent a valuable attribute of a permanent or cash value policy — can be utilized to fund expected or unexpected needs, although it may take a number of years to achieve substantial cash value buildup with some policy designs. When a participating whole life insurance policy featuring dividends (which are not guaranteed until actually paid) is used to purchase additional paid-up, guaranteed increments of insurance,[3] the guaranteed cash values may equal or exceed the cumulative premiums after a number of years.

There are a number of different policy styles that are designed to sustain for a lifetime — and we can now focus and differentiate policies that are fundamentally guaranteed as to premium cost — and those that are not.

> "Over the years, life insurance can complement other components of a well-designed financial strategy."

[2] Cash value may be used to supplement retirement funds and may be considered income tax-free if withdrawals are distributed up to the policy's cost basis and the gains are borrowed from the policy. Policy benefits are reduced by any outstanding loan or loan interest and/or withdrawals. Dividends, if any, are affected by policy loans and loan interest. Withdrawals above the cost basis may result in taxable ordinary income. If the policy lapses, or is surrendered, any loans considered gain in the policy may be subject to ordinary income taxes. If the policy is a Modified Endowment Contract (MEC), loans are treated like withdrawals, but as a gain first, subject to ordinary income taxes. If the policy owner is under age 59½, any taxable withdrawal is also subject to a 10% tax penalty.

[3] Paid-up Additions (PUA) are purchases of additional insurance (death benefit) that have a cash value. These purchases are made with dividends and/or a rider that allows the policyholder to pay an additional premium over and above the base premium. This creates the growth of death benefit and cash values in a participating whole life policy. Adding large amounts of paid-up additions may create a Modified Endowment Contract (MEC). A MEC is a type of life insurance contract that is subject to last-in-first-out (LIFO) ordinary income tax treatment, similar to distributions from an annuity. The distribution may also be subject to a 10% federal tax penalty on the gain portion of the policy if the owner is underage 59½. The death benefit is generally income tax free.

Section 2 (continued)

Guaranteed policy designs include:

Whole Life (WL)
Whole life is considered the oldest form of lifetime, level, *guaranteed* premium insurance in the United States, dating back to the mid-1700s. Because a life insurance policy can be in effect over decades, the careful pricing and design of the policy make this a strong and stable financial vehicle, no matter what the economic conditions. With a participating whole life policy from a mutual life insurance company, some of the premiums collected may be returned to policyholders in the form of dividends[4] as their *pro rata* share of gains through investment returns and favorable mortality experience and expense control.[5]

Secondary guarantee universal life
Looking a lot like a whole life policy, but typically with little or no long-term accessible cash value, guaranteed death benefit policies are a variation on term insurance — but designed to remain in effect to as long as age 125. Death benefits and premiums are guaranteed by the insurance company, although unlike participating whole life, there is typically no mechanism with guaranteed death benefit policies for the death benefit to increase over time. These policies are designed to remain in effect as long as the specified "no-lapse" premium is paid on time (and there are no loans or withdrawals).

The other design approach to modern life insurance is based on a projection of current experience with respect to life expectancies, the insurer's long-term investment expectations, and anticipated expense (and profit) requirements. These projections are incorporated into a variety of *current assumption* policies commonly known as universal (or flexible premium) life insurance. The major common element of all universal life (UL) policies (and other current assumption policies that are similar to UL policies) is that they do not have guaranteed premiums — in fact, there are no stipulated premiums at *all*!

Current assumption policy designs include:

Universal Life (UL)
Introduced in the late 1970's, UL was the first product to transfer the risk from the issuing insurance company *back to the policyholder* without directly addressing the possibility that the premium paid may not, in fact, be sufficient to support the policy for as long as the insured is alive. These policies have fewer guarantees and no fixed premiums or benefits, but are popular because they feature flexibility in amount and timing of premium payments. For not being bound to a fixed premium and payment schedule, the policyholder's obligation — and indeed, *responsibility* — is to maintain a positive balance in the policy account to cover monthly fees and expenses — for as long as the insured lives.

Adjustable life
The Adjustable Life policy, distributed by a limited number of companies, in many ways mimics a whole life policy, with some of the premium and death benefit flexibility of UL. Premiums and death benefits can be adjusted as account values accumulate, while still providing certain inherent guarantees.

[4] Dividends are not guaranteed. They are declared annually by an insurance company's Board of Directors.

[5] Whole life insurance provides death benefit protection for the whole of life as long as the guaranteed premium is paid. With payment of the guaranteed premium, you receive a guaranteed death benefit and guaranteed cash values inside the policy. Guarantees are based on the timely payment of required premiums and the financial strength and claims-paying ability of the issuing insurance company, which is measured by the four major ratings services. Costs for these benefits are reflected in lower cash values in the early years of the policy. In fact, 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.

Individual variable life insurance is issued by The Guardian Insurance & Annuity Company, Inc. (GIAC), a Delaware corporation, and distributed by Park Avenue Securities LLC (PAS). GIAC and PAS are wholly owned subsidiaries of The Guardian Life Insurance Company of America (Guardian). Guardian, GIAC and PAS are located at 10 Hudson Yards, New York, NY 10001.

Section 2 (continued)

Indexed Policies (IUL)
Another variation on UL, the crediting rate for an indexed universal life (IUL) policy is not subject to the company's investment results, but based on a formula derived from the actual experience of a broad index of stocks and/or fixed returns. While complex in design, these policies provide some "upside" in years in which stock indices achieve a gain and provide a floor — typically 0% to 2% — regardless of stock index losses over a defined period (typically 365 days). In years of positive gains in the index, the policy's current Cap rate may limit what the policy earns.

Variable policies (VL and VUL)[6]
Variable life and variable universal life policies offer the opportunity (and responsibility) for the policyholder to direct premiums among various investment options — typically equity and fixed sub-accounts — to support the underlying policy and death benefit. The long-term viability of the policy becomes a function of the premiums paid and the market values of the sub-accounts. This style of current assumption policy is unique among all others in that it is a security, and comes under the jurisdiction and licensing requirements of the Financial Industry Regulatory Authority (FINRA) and the Securities and Exchange Commission (SEC).

One or two insureds
In addition, survivorship life insurance (also called "second-to-die") variations on the above product styles are frequently used for estate planning purposes, where the death benefit proceeds are used to pay estate taxes and other costs associated with settling an estate. The common viewpoint is that policies that pay a death benefit on the *second* death should only be used when the surviving spouse will not need additional financial resources at the death of the first spouse.
(See Volume 1, Chapter 2.)

[6] Variable life insurance products and their underlying investment options are offered by prospectus only. Prospectuses contain important information, including charges and expenses, and should be read carefully before completing an application, investing, or sending money. Please consider the investment objectives, risks, fees and charges, and expenses of the investment company carefully before investing. A prospectus containing this and other important information can be obtained from a sales associate or by calling 1-800-441-6455.

Values in variable investment options will fluctuate daily and may be worth more or less than the original investment. Any individual soliciting these variable life insurance products must be a licensed insurance agent and a registered financial professional of the broker-dealer.

Variable products and their underlying investment options are not deposits of, or guaranteed or endorsed by any bank or depository institution and are not insured by the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Association, the Federal Reserve Board, or any other agency and involve risk, including possible loss of the principal amount invested.

Securities products and services are offered through Registered Representatives of Park Avenue Securities LLC (PAS), at 10 Hudson Yards, New York, NY 10001, 1-888-600-4667. PAS is a wholly owned subsidiary of The Guardian Life Insurance Company of America, New York, NY. PAS is a member: FINRA, SIPC.

Section 3

7 considerations in making life insurance policy choices

*"Most financial decisions begin with a self-assessment of risk tolerance. And risk tolerance can be an excellent way to start looking at the different styles of life insurance through the lens of what is **guaranteed**[7] and what is **not guaranteed**, and whether there will likely be **less** or **more** ongoing policy management required of your choice."*

Consideration 1:

What's the best policy for me?
The authors suggest borrowing a concept from the investment planning community — namely, using your risk tolerance to suggest an appropriate degree of emphasis on policies that are designed around *guarantees* versus *risk*. If your tolerance for investment risk is that you're more likely to be comfortable with guarantees, this in turn would suggest an initial look at whole life or guaranteed death benefit products. On the other hand, if your financial resources, long time horizon and investment experience lead you to have a higher tolerance for risk, you may be more drawn to the flexible premium variations of VUL, IUL and/or UL. The decision involves matching, as much as possible, your style to that of the many life insurance product options that also have a particular style or design focus.

The **Insurance Product Matrix** below provides additional context for the different choices of life insurance products and how each may fit your particular needs, objectives, time frames and resources.

Chart 2:

Insurance Product Matrix

Policy Type	Yearly Renewable	Level Premium Term	Universal Life (UI)	Variable Universal Life (VUL)	Indexed Universal Life (IUL)	No-Lapse Guaranteed Universal Life	Participating Whole Life
When to Consider	Very short-term needs, such as securing a 1-year term loan	Longer-term needs that are clearly not lifetime needs	Lifetime coverage with considerations of budgetary restrictions or the need for flexible payments	Lifetime coverage with some budgetary restrictions and a high tolerance for short-term volatility	Lifetime coverage with some budgetary restrictions, but lower tolerance for short-term volatility	Lifetime coverage at the lowest possible cost — with no need for flexible premium arrangements or the possibility of an increasing death benefit	Lifetime coverage in which cost is less of a factor than long-term benefits, including increasing death benefit and access to cash value, especially in retirement
When Not to Consider	Any uncertainty as to how long coverage will be needed	Any uncertainty as to how long coverage will be needed	When flexible payment opportunity may lead to failure to pay needed premiums	Those with anxiety over volatile market activity	Older insured; desire for predictable premiums	Need for cash value and/or death benefit growth	Need for large amounts of coverage and limited resources to pay premiums

[7] Guarantees are subject to the claims-paying ability of the issuing insurance company.

Section 3 (continued)

Policy illustrations and the illustration beauty contest
So far, your policy choices may sound pretty straightforward — at least until we try to assess the *current assumption* styles of life insurance that provide lifetime protection. If you ask, “What’s this going to cost?” about a UL, VUL, or IUL — the real answer is, “We don’t know.” And, as previously mentioned, the reason is that these policies don’t have mandatory premiums — you just have to make sure there’s enough money in the policy to keep it going as long as you live. Since that’s not a very definitive response, the insurance industry developed *policy illustrations* to — among other purposes — answer the “What’s it going to cost?” question.

For most people, the process of considering different styles of life insurance will include reviewing one or more company-generated policy illustrations. Even though most insurance companies use current and actual experience as required by regulations, illustrations are **representations of assumptions** made in the policy design. These assumptions are based on current mortality experience, investment returns, and expenses.

In a participating whole life policy, premiums are fixed and guaranteed, and offer a non-guaranteed dividend. In current assumption policies, the insurance company generally has an ongoing contractual right to increase its current expenses and reflect changing portfolio returns in its interest credits — subject to contractual maximums and minimums. Either way the policy is designed to work, the illustration suggests to the buyer a view of how policy values might look in the future through economic enhancements that exceed its guaranteed pricing elements. However, these are still *assumptions* and not guarantees, especially with UL-style policies.

The proper use of an illustration is to show what is and is not guaranteed in the policy and define some of the terms used in the policy. It also demonstrates a policy’s design and flexibility. This would include what may happen with premium offset,[8] or if withdrawals are made in later years to supplement income, or if riders are utilized to enhance the policy’s values.[9]

The *improper* use of an illustration is to specifically portray numbers in order to compare policies.[10]

“How does a consumer evaluate the credibility of two illustrations from different companies, or about different products, or products with different guarantees and enhancements? Most problems arise because the illustration creates the illusion that the insurance company knows what will happen in the future and that this knowledge has been used to create the illustration.”[11]

(See Volume 1, Chapter 5.)

[8] The premium offset year is not guaranteed. The offset is based on the amount of paid-up additions and payment of non-guaranteed dividends.

[9] Riders may incur an additional cost or premium. Riders may not be available in all states.

[10] Final Report of the Task Force for Research on Life Insurance Sales Illustrations under the Auspices of the Committee for Research on Social Concerns, Society of Actuaries, 1992.

[11] For policies with level death benefits, the net amount at risk equals the policy’s stipulated death benefit minus the cash value for any point along the continuum from policy purchase until death.

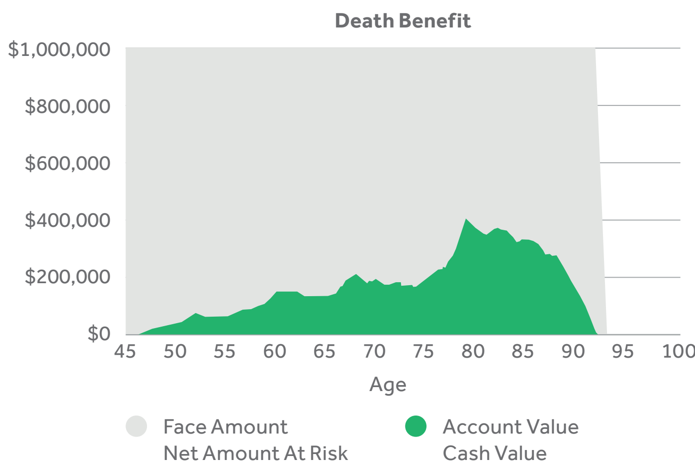
Section 3 (continued)

Consideration 3:

The illustration challenges for Universal (Both Traditional and Equity Index) and Variable Universal Life
Universal life policy development and enhancements would not have been possible without the personal computer. In turn, because of the volatility expected in the sub-accounts of a VUL product (and with no losses but uncertain "upside" in a traditional UL or the newer IUL products), showing the prospect how the policy works became a real challenge for the insurance industry.

As seen in Chart 3 below, the underlying issue — and admittedly, on first blush, seeming like a mere technicality — is that for policies in which cash value can fluctuate (and even when there are no negative returns) — there is a simultaneous adjustment in the net amount at risk (the part of the death benefit that the insurance covers above the cash value), and the long-term economic effect can be difficult to demonstrate in a policy illustration.[12]

Chart 3:



Over time, when there are fluctuations in cash value that result in the need for *more* pure insurance (i.e., "net amount at risk"), policy charges will be higher than anticipated and will further reduce the cash value — potentially resulting in a downward spiral of value to sustain the policy. This is especially critical as the insured reaches age 70 or older, and unanticipated increases in net amount at risk can cause the policy to terminate before the insured's death.

The Studies' authors point out that to overcome the potential for declines in the cash value, policy owners will generally want to pay *more* into a VUL policy than the illustration otherwise suggests. While this is a more conservative illustration approach, it should produce a better (or at least safer) approach for the buyer.

As a general rule of thumb, the authors recommend that the calculation to determine how much to pay into a VUL policy should be made using an illustration "crediting rate" lower than the average return in the chosen asset allocation that will be reflected in sub-accounts supporting the policy..

Consideration 4:

High illustrated rates vs. reality
A further consideration to the challenge of helping consumers understand how *their* policy *may* perform in the future is that illustration regulations restrict UL policy illustrations from using values that are greater than the current crediting rate. However, VUL illustrations may use *any* gross annual rate up to a maximum of 12%. While IUL policies are *not* considered securities, illustrations for such products allow a long-term historic average return of a chosen index (e.g., the S&P 500® Index), which may result in illustrations portraying the effect of a constant 6% to 7% accumulation rate per annum. If a policy is purchased with an expectation of paying as little in premiums as possible over time, a VUL illustration (a security) or a UL or an IUL illustration (not a security) can allow you to "solve" for a significantly lower premium at crediting rates that may not be sustainable. If that's the case, *the resulting low premium projection is unlikely to sustain the policy*, even for a person with an average life expectancy. Thus, it is important that the right policy be matched to the client's needs — and to be aware that certain types of UL policies may *illustrate* a better premium at an annual return assumption of 12% or 8% than a UL policy's crediting rate of 4% or 5%, or a whole life's "dividend interest rate" of 6%, but only *actual experience* over many years or decades will determine the real benefit — and real cost — of these very different styles of policies.

Above all, your financial professionals must be on board to help you periodically monitor your life insurance policy's results in order to maximize the effectiveness of their financial strategies. Statistical in-force evaluations of these life insurance policies should be conducted at least every 3-5 years.

> "It is human nature to be drawn to the attractive impossibility rather than the less attractive probability."
>
> A modern interpretation of Aristotle's "Poetics."

[12] Transactions of Society of Actuaries — 1991–1992 Reports: "Final Report of the Task Force for Research on Life Insurance Sales Illustrations Under the Auspices of the Committee for Research on Social Concerns"

Section 3 (continued)

Consideration 5:

Lifelong goals and gaps: underlying factors to consider when choosing life insurance
The good news is that life insurance products have evolved over the years — with the times, the economy, and individual needs and desires. There is a broad range of choices to dovetail with needs as well as the client's situation and preference/risk profile. While peer companies of The Guardian Life Insurance Company of America (Guardian) typically utilize a similar process to design products, their pricing, values, flexibility, and other features can vary widely. Outside influences can also affect product benefits and outcomes.

For example, in the 1970s and '80s, spiking interest rates, combined with the underlying high rate of inflation, had a negative effect on traditional (i.e., guaranteed) life insurance products. The attraction of superior total returns on relatively short-term "new money" portfolios of universal life products (i.e., current assumption) caused a decrease in sales of whole life products with their longer, slower-moving "old money" investment portfolios. Though whole life was not a bad deal, the focus was on paying as little in premiums as possible for the highest return, which drove many clients to the UL marketplace.

Many life insurance companies have a similar mix of investments held in reserve to fulfill obligations to their policyholders. As defined in their annual statutory statements, many of these companies' investment portfolios are comprised of U.S. government and high-grade corporate bonds, high-grade commercial mortgages, and policy loans, with minimal investment in common stocks or other higher-risk investments that can jeopardize the insurance company's ability to meet its future promises.

Creating a uniform approach to configure pricing and contractual benefits has long been a challenge to the industry — especially when it comes to illustrating possible future benefits — where so many variables in the present must be considered for the future time horizon of life insurance. *(See Volume 1, Chapter 6.)*

Consideration 6:

Buy Term and Invest The Difference (BTID) — 2 views
This section addresses a common opinion that is generally considered an unquestioned truth among the many "voices" in the financial media. Buying term insurance and investing the difference may make sense in certain situations. These include:

- When there is a quantifiable time period for needed or desired protection, with a certainty that life insurance will not be required beyond that period;
- When the buyer is young and doesn't contemplate a lifetime need or expense for life insurance;
- When the difference in premium amounts will indeed be invested (because many times it is not and the savings opportunity is overlooked or diverted to more short-term expenditures); or
- When there is truly a lack of sufficient funds at the time to purchase permanent insurance.

For anyone making a buying decision that cannot check off at least one of the above criteria, term insurance may not fulfill the buyer's expectations.

View 1: BTID with a focus on price

Level term insurance often becomes unaffordable after the initial guarantee period. The increase in just the first year following the typical guaranteed premium expiration is more than 10-fold. In the example provided of a 33-year-old male, preferred health, the guaranteed annual premium for a 10-year term policy with a $1 million death benefit jumped from $355 during the initial 10-year period to $3,865 in the 11th year, and continued to increase annually thereafter.

View 2: BTID with a focus on legacy

If a client wishes to leave a specific death benefit and buys term insurance to build a legacy that survives the term insurance, he or she must be confident of consistent and historically high returns on the investment portion of this strategy. From 1990 through the 2000s, the S&P 500 Index experienced great volatility over a fairly short time frame, achieving returns in excess of 37% in 1995 — but with returns plummeting to -37% in 2008. For many people, this volatility is not worth the risk of having too little to leave as a legacy, especially when the whole life alternative is available (for those who have the "luxury of choice" to pay the initially higher whole life premium).

Section 3 (continued)

Consideration 7:

Policy choices made on the basis of price versus value
Price versus value is a classic issue having to do with duration of use and predictable durability or value. Consider the often attributed Ben Franklin's observation from Poor Richard's Almanac that " ... the bitterness of poor quality remains long after the sweetness of low price is forgotten." Yet it is still understandable that the price/value range will be explored by financially sophisticated consumers.

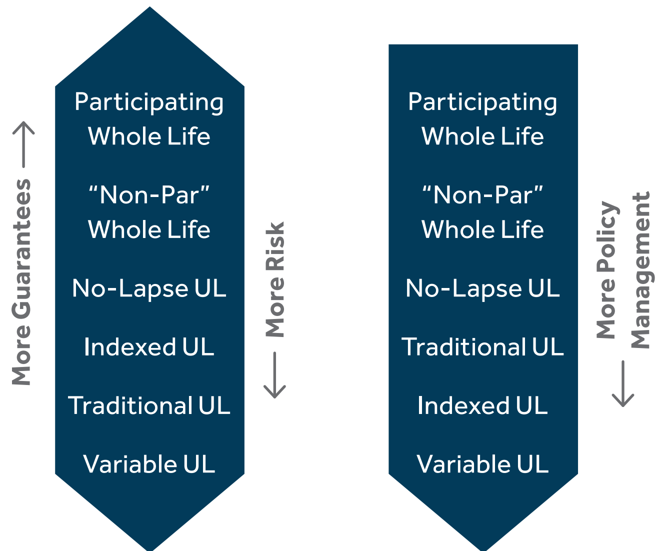
We all use different filters in the decision-making process of buying — and those filters are probably multi-dimensional. Our considerations are different whether buying cars or even paper towels; longterm investments or money market accounts; fancy homes or a basic studio apartment. There are tangible, objective financial considerations — and there may be many more subjective considerations.

When it comes to life insurance, are you "price" focused or "value" focused? Are you concerned about guarantees or are you tolerant of risk in your life insurance purchase decision-making? Do you mind managing your life insurance policy — or would you rather have one that doesn't need much attention?

The key message here is:

"For my specific budget, time frame of need, risk tolerance, overall financial situation and resources, I must figure out what type of life insurance best meets my needs."

What's important to you about life insurance?
Your risk tolerance, resources, time horizon, and preference for guarantees or projected values — as well as the amount of policy management that may be required — may help guide you to an appropriate insurance policy or policies designed for lifetime coverage.



These characterizations are the authors' opinions based on their research and experience. The relative postions of various styles of life insurance designed for lifetime coverage are intended to be used for discussion with a life insurance professional, who can apply this conceptual arrangement of policies based on guarantees or projected values to your own circumstances.

Section 4

Ready to deploy a core financial asset

"Diversification is not just for stocks and bonds. Life insurance is an important asset class that can offer meaningful living values to the entirety of a consumer's wealth, while completing the traditional uses of financial protection at the time of death."

3 Key educational scenarios

Key 1: Modern Portfolio Theory, asset classes, and life insurance

Developed in 1952 by Harry Markowitz, Modern Portfolio Theory has become a well-known economic theory of investing. The simple idea is to achieve diversification through the use of dissimilar asset classes in an attempt to achieve the best risk/return balance for a portfolio.

Diversification is critical for a well-thought-out portfolio and the primary asset classes include:

- Equities (common stocks)
- Fixed income (bonds and mortgages)
- Money market (cash)
- Guaranteed cash flows (annuities)
- Real estate and other "hard" assets

Please see important disclosures at the end of this Consumer Guide about each primary asset class listed above.

While we invest, no matter what precautions are taken, there is typically some reduction of earnings from all of the above asset classes due to volatility, inflation, taxes, and fees.

This section expands the discussion, highlighting life insurance as a viable asset class of substantial value.

Here's why financial professionals today are looking at life insurance more closely in helping clients build solid portfolios:

- The death benefit provides cash when it is needed the most;
- The cash value provides the policy owner with living benefits;[13]
- The tax-deferred cash accumulation can be accessed income tax-free (under current tax law);[14]
- The death benefit is payable income tax-free and quite possibly estate tax-free;[15]
- Policy proceeds may be beyond the reach of creditors.[16] (Check with authorities in your state of residence.);
- A life insurance policy can be funded with affordable periodic payments;
- Unique to life insurance — with a Waiver of Premium rider[17] — a policy may be self-completing in case of disability;
- The death benefit is based on the event of death — not a market event that can cause a market value adjustment; and
- Premiums may be funded with capital earned from other invested assets in lieu of budgeted income.

Assessing a financial portfolio — with and without life insurance

The following discussion is about financial context, and not intended to tout one fixed-income sub-class over another.

When:

1) You are considering the purchase of life insurance intended to last a lifetime

2) You have resources to use guaranteed premium policies, such as participating whole life

3) You have a portfolio consisting of diversified asset classes

Then making permanent life insurance a part of the portfolio can be an option to consider.[18]

[13] In the early years of a policy, cash values can be below the total amount of premiums paid. Some whole life polices do not have cash values in the first two years of the policy and don't pay a dividend until the policy's third year. Talk to your financial professional and refer to your individual whole life policy illustration for more information.

[14] Policy benefits are reduced by any outstanding loan or loan interest and/or withdrawals. Withdrawals above the cost basis may result in taxable ordinary income. If the policy lapses, or is surrendered, any loans considered gain in the policy may be subject to ordinary income taxes. If the policy is a Modified Endowment Contract (MEC), loans are treated like withdrawals, but as gain first, subject to ordinary income taxes. If the policy owner is under age 59½, any taxable withdrawal is also subject to a 10% tax penalty.

[15] Guardian, its subsidiaries, agents and employees do not provide tax, legal, or accounting advice. Consult your tax, legal, or accounting professional regarding your individual situation.

[16] State creditor protection for life insurance policies varies by state. Contact your state's insurance department or consult your legal advisor regarding your individual situation.

[17] A Waiver of Premium rider waives the obligation for the policyholder to pay further premiums should he or she become totally disabled continuously for at least six months. This rider will incur an additional cost. See policy contract for additional details and requirements.

[18] While this discussion is about the synergy or "companionship" of two members of an asset sub-class, life insurance cash values are not the same as a bond. There are differences in liquidity, guarantee of principal, immediate access to income, and underlying risk. A qualified financial professional can review those differences with you.

Section 4 (continued)

To supplement Social Security income during retirement, many people rely on employer-sponsored retirement plans, investments, and life insurance. As the time to retirement gets shorter, many investment professionals recommend scaling back on more volatile investments and increasing fixed components. The cash value of permanent life insurance is one such fixed component.

As appropriate to your other resources for retirement income, whole life insurance cash value can be used as a supplemental retirement income resource. It's also an asset that may, at times, be funded from the proceeds of other assets — such as paying the premiums from the interest generated from other traditional fixed assets. *Please remember that this technique is not intended as a prediction of future performance!*

Life insurance is also a consideration for legacy planning. Because the life insurance death benefit is paid in full at the event of death, no matter what the "timing," the legacy value is a meaningful and valuable asset.

In any case, consumers must balance considerations of the need for current investment income with using that income for the purchase of life insurance. A Guardian financial professional can assist you in evaluating solutions for balancing short-term income needs against long-term objectives.

Please refer to the end of this document for additional disclosures to help differentiate between these different financial options. Treating life insurance as an asset class can be in a client's interest, but individual circumstances and resources are paramount in any such consideration. *(See Volume 1, Chapter 9.)*

Key 2: taxes, fees, and inflation can make a difference
When evaluating major asset classes over time, you should consult a tax advisor about account taxes, fees, and inflation — which, when subtracted from a nominal return, gives you the "real" return of the asset. In other words, "It's not what you make, but what you keep" — making this the basis for refining the asset diversification choices you make in your overall financial portfolio.

Assessing whole life insurance policy cash values using a similar methodology, the results may show that cash value internal rates of return compare very similarly within other fixed assets — which are frequently used by life insurance companies within their general account assets.[19] *(See Volume 2, Chapter 3.)*

Key 3: protection at the core
Regardless of your financial objectives, the primary purpose of life insurance is to protect an individual's Human Life Value (HLV). Due to the critical nature of this basic protection, some recommend that ideally at the core of every life insurance portfolio is the kind of guaranteed protection that only whole life insurance can provide. The "core value" of an individual's life insurance portfolio refers to the portion of insurance that provides guaranteed protection for the HLV through the use of participating whole life insurance. For many, the amount of "core values" can range between 50% and 75% of total HLV.

When that "core value" is in place, depending on your risk tolerance and financial circumstances, you may seek to expand your life insurance portfolio to include various insurance policy types that together help meet other longer-term goals and objectives. *(See the discussion of Tiers 1–3 in Volume 2, Chapter 4.)* There is no specific formula or point at which you might transition from fulfilling HLV with basic insurance protection to a more sophisticated process incorporating asset optimization, which leads to the next topic: Efficient Choices.

Adding to the core by building a life insurance portfolio with Efficient Choices
While Modern Portfolio Theory emphasizes diversity in investment options, a similar process of diversification can apply to the efficient selection of life insurance policies intended for lifetime use, especially when acquiring a cumulative face amount in excess of $3 million–$5 million.

Selecting a mix of the right products involves consideration of your risk tolerance, time horizon, desired premium outlay, development and access to cash values, and death benefit requirements. The major forms of life insurance present varying combinations of most of these attributes, but no one policy can provide *all* attributes. Taking into consideration a client's risk tolerance, it is possible to form an initial concept for balancing the various desired policy attributes into a portfolio of policies that, as with general investment portfolios, benefits from this sophisticated form of diversification.

For example: The Studies' authors discuss how a client who is relatively conservative with her investment choices but for whom long-term value is important (including access to cash value and naturally occurring increases in death benefit over the years) may be interested in a portfolio of as much as 80% whole life, with 20%–30% of the balance in a no-lapse UL with perhaps a small amount of VUL.[20] A client with a more balanced risk tolerance whose considerations for lifetime life insurance is strictly based on price (and who is also willing to forgo access to cash value and increasing death benefits) may choose a high percentage of no-lapse guaranteed universal life, perhaps in combination with variable universal life. There are so many factors to consider that it takes professional experience to help guide the buyer to make efficient choices. Once again, Guardian financial professionals have access to resources that can help the client fine-tune their insurance policy options. *(See Volume 1, Chapter 10 and Volume 2, Chapter 4.)*

[19] There are material differences to these investment types. Please refer to the additional disclosures found in the back of this guide.

[20] There is no guarantee as to the benefits of policy portfolio diversification. Diversification does not ensure a profit or guarantee against loss.

Section 5

Policy management considerations

"As much as we are drawn to low price and/or big gains (often without understanding the true underlying risk), important assets need to be managed for ongoing relevance. Life insurance is an important asset to most families and businesses who depend on a 'key' spouse/father/mother/ business owner."

'New' versus 'old' policies and 'illustrations and replacement' versus 'remediation'

While credibility is given to the balance of "something old, something new" in preparing for a wedding, advertisers have impressed consumers for more than 100 years that "new and improved" should be valued over "old and outdated," whether it is saddle soap, automobiles or computers. But when it comes to life insurance, such a notion often does not apply. Newer policies are designed to be funded as far out as age 125, but whole life policies with the previous age 100 standard are not only frequently just as good, but may — all things being equal — have better guarantees and better dividend scales.[21] And, since a participating whole life policy's mortality and other expenses are typically based on the company's broad experience rather than that of just one series of policies, more favorable claims experience will be taken into account in the calculation of present and future dividends, when paid. Further, with an insurer's right to challenge any death claim within two years of issue (a right that insurers do not waive simply because you might want to replace old with new), you should not lightly enter into an exchange of policies. If an agent persists in the recommendation, ask the agent if she or he has assessed your specific situation with the Replacement Questionnaire, an independent analytical resource developed by the Society of Financial Service Professionals. *(See Volume 2, Chapter 5.)*

Financial knowledge vs. Life insurance knowledge

Financial knowledge has become more specialized since the 1960s as the number of products and their complexity have increased. With the advent of the internet, where individuals can attempt to acquire and manage their own investment and insurance choices, there are many resources available for information, advice, and execution of the individual's wishes.

Consider: You are likely to have many financial, legal, and tax issues to review as you gain experience in your chosen field of work — and the responsibility can, at times, be overwhelming. That's why the best scenario for the consumer with growing financial issues is a relationship with a team of like-minded individuals, each with specific professional knowledge in the financial arena. *(See Volume 1, Chapter 11.)* Such a team — often consisting of an attorney, an accountant, a financial professional and an insurance specialist — can be one of the best resources you can assemble! Less likely to add value are "hot tips" and other words of advice from friends and associates who are not involved in any of the team's specialties. While we're all drawn to "... the attractive impossibility rather than the less attractive probability ..." clichés about the value of "free advice" are often true!

[21] Dividends are not guaranteed. They are declared annually by an insurance company's Board of Directors.

Section 5 (continued)

Policy management

Financial "gurus" are generally focused on the buying and selling process of the portfolio components they favor. Even in discussions of life insurance, the primary consideration seems to be which product to purchase. Prior to the introduction of largely non-guaranteed policy styles, it might have been possible to "buy a policy and stick it in a drawer," but today's diversity of policy styles and risk profiles makes it important to pay attention to monitoring, managing, and measuring the ongoing success of the life insurance assets.

Some questions to consider as time and experience with a life insurance policy are acquired:

- Does the insurance policy remain suitable to the policyholder's situation and expectations?
- (If a UL, IUL, or VUL policy) Are scheduled premiums projected to be adequate to sustain the policy to maturity? Whatever the answer: Are the underlying projections based on realistic or tolerable expectations about an uncertain future?
- Is the insurance company providing a high level of service and guidance?[22] *(See Volume 1, Chapter 12.)*

Ask your insurance professional to help you create a written Life Insurance Policy Management Statement. That is an outline that helps you manage your policy well into the years it is protecting you, but still requires management. Such an informal document helps to clarify your current considerations of risk tolerance (when it comes to protecting your family or business), the degree to which cash value and increasing death benefits over time may be of value, and how you currently feel about changes in your insurability or the insurance company's financial condition — so that you can later refer to your earlier considerations and reflect on their value when something about you or your policies changes.

In addition to putting a Life Insurance Policy Management Statement and the resulting insurance policies in place, ongoing assessment and careful monitoring are essential for a successful financial strategy that could span a lifetime. Guardian's The Living Balance Sheet® — a proprietary, web-based financial and service platform — can be an ideal tool to accomplish this. Because life insurance can provide financial protection over generations, it is critical to look to the issuing insurance company for its stability, quality of products, customer service, and the knowledgeable experience of its financial professionals.

[22] Financial information concerning The Guardian Life Insurance Company of America as of December 31, 2018, on a statutory basis: Admitted Assets = $58.5 Billion; Liabilities = $51.3 Billion (including $44.3 Billion of Reserves); and Surplus = $7.2 Billion.

Section 6

Conclusion

"There are more than 900 life insurance companies in the U.S., all with varying degrees of financial strength and all offering policies for your consideration. Their offerings include policies that provide coverage in the short term as well as the long term — with varying degrees of guarantees or risk. What's best for ***you***? To answer that question, you'll likely want to find a financial professional with whom you have confidence — who, in turn, is backed by a life insurance company that has earned respect for its client focus, has qualified, well-trained agents with significant technical resources, and demonstrates historical and ongoing high levels of company financial strength."

As we stated in the introduction of this Consumer Guide, the financial strategy of *Life Insurance as an Asset Class* is an approach to help people protect their lives, while creating an asset for their overall financial portfolio. As careers flourish and resources allow for personal investment and a long-term financial strategy, life insurance products such as participating whole life may be a valuable part of a person's or business's overall financial portfolio, complementing existing fixed-income assets that help to moderate risk and volatility in a traditional asset mix.

After reading this guide, if nothing else, you now have a sense that life insurance is important — and that it's not necessarily easy to make smart decisions, especially when there's so much static in the financial arena! But at the end of the day, what's important is figuring out what's important to *you* about life insurance — and working with a qualified insurance professional who will bring common sense and a likely purposefulness to your thinking about life insurance.

Since 1860, Guardian has provided high-quality products and services to meet a broad array of personal and business needs to enrich the lives of the people we touch.

Guarantees are based on the payment of all required premiums and the claims-paying ability of the issuing insurance company. Policy loans and withdrawals affect the guarantees because of the reduction in death benefit and cash values.

This information should not be considered tax advice. Any tax statements contained herein are not intended to be used, and cannot be used, for the purpose of avoiding tax penalties.

Please consult your independent tax advisor as to any tax, accounting, or legal statements made herein. Statements contained herein are based upon information furnished from independent sources. While we do not guarantee their correctness, we believe them to be reliable and have ourselves relied upon them.

The Consumer Price Index (CPI) measures prices of a fixed basket of goods bought by a typical consumer, including food, transportation, shelter, utilities, clothing, medical care, entertainment, and other items. The CPI, published by the Bureau of Labor Statistics in the Department of Labor, is based at 100 in 1982 and is released monthly. It is widely used as a cost-of-living benchmark to adjust Social Security payments and other payment schedules, union contracts, and tax brackets. CPI is also known as the cost-of-living index.

Mentioned Index & Asset Class Descriptions: Bonds are debt investments in which an investor loans money to an entity (corporate or governmental), which borrows the funds for a defined period of time at a fixed interest rate. Bonds are subject to certain risks, including loss of principal, interest rate risk, credit risk, and inflation risk.

The value of a bond will fluctuate relative to changes in interest rates; as interest rates rise, the overall price of a bond falls. U.S. government bonds, or Treasuries, are negotiable debt obligations of the U.S. government, secured by its full faith and credit and issued at various schedules and maturities. Income from intermediate government bond data is based on a one-bond portfolio with a maturity near five years. Long-term government bond data is based on a one-bond portfolio with a maturity near 20 years.

Municipal bonds are debt obligations issued by states, cities, counties, and other governmental entities. Municipal bonds offer a predictable stream of income which is free from federal and, in some cases, state and local taxes, but may be subject to the alternative minimum tax. Because of these tax savings, the yield on a municipal bond is usually lower than that of a taxable bond. Higher-grade municipal bonds have higher degrees of safety with regard to payment of interest and repayment of principal and marketability in the event you must sell before maturity. This study uses Bloomberg Barclays Municipal Bond Index as a general representation of the municipal bond market.

A stock is a share in the ownership of a company. As an owner, investors have a claim on the assets and earnings of a company as well as voting rights with the shares. Compared to bond owners, stock investors are subject to a greater risk of loss of principal. Stock prices will fluctuate, and there is no guarantee against losses. Stock investors may or may not receive dividends. Dividends and gains on an investment may be subject to federal, state or local income taxes.

Standard & Poor's 500 Stock Index is an index consisting of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large-cap universe.

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Whole life insurance provides death benefit protection for the whole of life as long as the guaranteed premium is paid. With payment of the guaranteed premium, you receive a guaranteed death benefit and guaranteed cash values inside the policy. Guarantees are based on the timely payment of required premiums and the financial strength and claims-paying ability of the issuing insurance company, which is measured by the four major ratings services. Costs for these benefits are reflected in lower cash values in the early years of the policy. In fact, 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.

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