

TOOLBOX

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PAR FOR THE COURSE

Participating whole life policies do have value, especially when taxes are considered.

ON MORE than one occasion, I've exchanged views with clients and colleagues about participating (par) whole life. At issue are various nuggets of wisdom passed along by industry associates, and others who share a view that par provides a poor rate of return.

While whole life providers have given advisors a plethora of marketing material to explain the workings and performance of par funds, I've yet to see an analysis that answers the questions with time-weighted average rate of return numbers.

Par's been around a long time, but its name is a bit of a misnomer. Par whole life is not just a form of insurance; it's a bundled product that combines insurance and investments. While alternative products such as universal life make a clear distinction between the insurance and investment portions of the policy, that distinction is not as clear with par whole life. Consider the various parts that make up a par whole life policy:

- **Face Value**—the basic death benefit associated with the policy. It's a set value that does not change.
- **Guaranteed Cash Value**—a contractually guaranteed value associated with the policy. This cash value follows a predetermined schedule starting at zero and beginning to grow in years one, five, ten or 15 depending on the policy. The cash values grow until the insured turns 100, at which time the guaranteed cash value matches the face value.
- **Dividends**—premiums paid in excess of the cost of insurance are invested within a pool known as the par fund. This fund then invests in a portfolio that's

heavily weighted in bonds. Returns from this fund, along with profits from improvements in mortality, are distributed to policyholders in scheduled dividend payments. Dividends can either be paid out, left on deposit, put against the premium, used to purchase an investment fund or to purchase more fully paid up insurance (paid up additions).

Let's look at the latter option, paid-up additions, as it results in the largest long-term death benefit and cash value options.

A par whole life policy will pay the insured the face value on death, or on maturity at age 100. At the same time, funds paid in excess to the policy generate returns that will be paid back to the policy. This amount, or the insurance/investment they generate, will also be paid at time of death.

However, it's not necessary to wait until death. The policyholder can benefit from policy ownership by:

- Withdrawing dividends;
- Borrowing against the guaranteed cash value; or
- Surrendering the policy in exchange for the guaranteed cash value and accumulated dividends.

Basic Assumptions

Analyzing the return on any insurance product is always challenging. There are an infinite number of variables to consider: age, gender, health, smoking status, issuer, product, benefit amount, payment period, and so on. We'll assume the dividend schedule holds throughout the policy's lifetime, and that the policyholder is:

- A male, non-smoker, age 40;

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- Using a whole life policy from one of the major issuers payable to age 100; and
- Holding a \$1 million face value policy with no riders and dividends purchasing paid up additions.

The values (see “Par Value,” page 10) represent various forms of payoffs to the consumer. The next challenge is to identify what’s invested in this policy. Remember par whole life is a bundled product, so the premium itself is also bundled to represent the cost of each of the associated benefits. To measure the return accurately, it’s necessary to break down the premium and attribute the proper portion of that premium to each benefit. The data needed to do this isn’t provided by the insurance companies. For this analysis, make the following assumptions:

- Total Premium—quoted as \$22,482 per year;
- Face Value—The best comparison basis would have been a T100 no cash value policy. However since the issuer used in the example does not

Measuring Returns

Year	Age	ROI	RIF	ROS	ROD
5	45	155.7%	-28.5%	-10.4%	89.5%
10	50	50.8%	-4.8%	0.1%	30.9%
15	55	27.8%	1.6%	2.6%	17.6%
20	60	18.2%	4.1%	3.5%	12.2%
25	65	13.0%	5.3%	4.0%	9.5%
30	70	9.9%	5.9%	4.3%	7.8%
35	75	7.8%	6.1%	4.5%	6.8%
40	80	6.3%	6.1%	4.6%	6.0
45	85	5.2%	6.1%	4.6%	5.5%
50	90	4.4%	6.0%	4.6%	5.1%
55	95	3.7%	5.9%	4.5%	4.9%

offer such a policy, the annual minimum premium for a T100 universal life policy was utilized. This resulted in a face value premium of \$5,592;

- Guaranteed Cash Value—again, the issuer doesn’t offer a direct match, so, I settled for a policy offered by another issuer with long term guaranteed cash amounts similar to the whole life prod-

uct. When subtracting the premium of that policy from the face amount, it resulted in \$5,253 being attributed to the guaranteed cash value; and

- Dividends—subtract both face value premium and guaranteed cash value premium from the total premium, leaving a corresponding value of \$11,640.

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Par Value

Year	Age	Face Value	Guaranteed Cash Value	Dividend Value	Total Cash Value	Death Benefit
5	45	1,000,000	69,000	35,375	104,375	1,139,272
10	50	1,000,000	147,000	101,239	248,239	1,334,121
15	55	1,000,000	229,000	210,602	439,602	1,585,005
20	60	1,000,000	302,000	377,454	679,454	1,890,222
25	65	1,000,000	372,000	620,834	992,834	2,251,682
30	70	1,000,000	453,000	960,425	1,413,425	2,676,134
35	75	1,000,000	530,000	1,409,972	1,939,972	3,169,188
40	80	1,000,000	602,000	1,986,585	2,588,585	3,743,901
45	85	1,000,000	665,000	2,699,807	3,364,807	4,417,477
50	90	1,000,000	724,000	3,565,498	4,289,498	5,209,560
55	95	1,000,000	790,000	4,613,185	5,403,185	6,137,177

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continued from page 10 To measure returns based on these cash flows, identify which inputs and outputs apply to the calculations. The average consumer will want to know:

- What return am I getting from the insurance portion of this policy? Consumers have several options

available for permanent protection. So determine what return they'll receive from the actual insurance benefit (ROI). To measure ROI on the policy, consider the face value premium versus the face value.

- Is there any Return in Force (RIF)? To calculate RIF, consider the only

available in force payout, dividends, and compare them to costs.

- What return am I getting on the premium beyond the cost of insurance if I surrender the policy? To find out, we'll measure what a consumer yields for funds in excess of the cost of insurance on surrender, or Return on Surrender (ROS). This number will look at the guaranteed and dividend cash values paid versus the premiums associated with both.
- What is my Return on Death (ROD)? To calculate, just consider the total payout (face value, plus paid up additions) versus all premiums paid.

Results

The ROI on the policy started out very high and decreased as time passed (see "Measuring Returns," page 10). But, if we examine the returns in the range of the client's life expectancy (75-85) we see that the ROI is a healthy 5.2% to 7.8%. Insurance by its nature is a guaranteed payout, therefore if this ROI is compared to other guaranteed investment options, such as GICs or bonds, a 5.2% to 7.8% tax free rate of return is very competitive.

It takes 20 years before the RIF approaches a return similar to that of fixed-income yields. After about 30 years, the RIF plateaus at about 6%, pre tax. As with the RIF, the ROS starts out negative and then increases—hitting a plateau of about 4.6%, pre tax. Unlike the RIF, the initial returns aren't as negative, due to the inclusion of the guaranteed cash value. The returns also are not as positive since they consider all premiums paid to the policy.

The ROD has high initial returns that are more muted than the ROI. This is due to the inclusion of the cost of the guaranteed cash and dividends. At the same time, the **continued on page 14**

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continued from page 12 ROD's longer-term return numbers (post year 40) are greater than the ROI. This is because the paid up additions increase the death benefit over time and at least partially compensate for the increased cost. It's important to remember this is a tax-free return, making it more attractive than similarly yielding products. In fact a 5.5% to 6.8% tax-free compound rate of return is equivalent to the after-tax yield on a heavily equity-based balanced portfolio.

From an insurance standpoint, clear value is derived. Even when compared to the return of its non-cash insurance rivals (ROI), it provides a tax-free return of 5.5% to 6.8% at life expectancy. However RIF and ROS show there is also clear value to be derived while alive. RIF proves a client can achieve a

long-term, fixed-income level of return from the dividend payouts (not surprising given that par funds are heavily fixed-income weighted). As well, ROS demonstrates that should the client no longer need the insurance or investment aspects of this policy and wish to terminate, he or she would receive the equivalent of a pre-tax return similar to other secure investments.

Strategies

So, what kind of consumer would benefit most from a par whole life policy? Essentially it's a person who:

- Needs permanent insurance;
- Desires or needs to invest;
- Is looking for a vehicle that will provide a fixed income equivalent return while he or she is alive; and
- Is looking to grow his insurance

amount on a regular basis and leave behind an estate that will have earned a return that rivals an after-tax return on a heavily equity-based balanced portfolio.

One strategy I use is to include the dividends within a par whole life policy as fixed income in the client investment policy statement. Since paid dividends are guaranteed to the client and increase according to a set schedule, they demonstrate the stability of commonly accepted fixed income products.

While it's unclear where the argument that whole life provides a poor return comes from, it's apparent the policies produce significant returns for clients' heirs. Detractors aside, the numbers show there's clearly value to good old fashioned participating whole life policies. ^{AE} **PEREIRA**