Preface

The majority of writings on life insurance fall into three categories: Category one positively advocates the needs for life insurance, explains the benefits of differing product types, and attempts to demonstrate the economic advantages of permanent life insurance products—both guaranteed and non-guaranteed—through the use of traditional, constant crediting rate (and current cost of insurance) assumption policy illustrations. This first category is designed to be a friendly, helpful guide to the prospective life insurance purchaser. Category two, on the other hand, takes the approach that the needs for life insurance are a necessary temporary evil that should be met with term life insurance coverage and that coverage should cease at retirement, at the very longest, if not well before that time. This category is the classic theory of "buy term and invest the difference," with the difference intended to accumulate to an amount that negates the need for life insurance. Category three tends to take the form of educational textbooks intended either to provide the requisite life insurance knowledge to prepare the reader to sit for the state insurance license exam, or to provide the fundamental life insurance basics for a college course in either risk management, insurance, or financial planning. These educational publications, although generally presented in a neutral manner, tend to espouse the life insurance industry traditional marketing approaches, nomenclature, and positions.

By comparison, this book takes an entirely different approach. The author sincerely believes that life insurance is a form of intangible personal property that is designed to solve financial needs and problems—primarily the economic loss upon the death of the insured or insureds—in many cases in the most effective and efficient manner. There are many legitimate needs for life insurance in both personal and business planning situations. Some of these needs are truly temporary and are best funded with term insurance. Alternatively, planning needs of a more permanent nature tend to be funded with policies designed for long-term or life-long permanent protection. There are a variety of permanent life insurance products available in the marketplace. Some products guarantee the premium payment amount, duration period of the payment amount, cash value, and death benefit to the maximum age of the mortality table prescribed by law at the issuance of the policy, which is generally age 100 or 120. Other products contain maximum cost guarantees and, maybe, minimum crediting rates, and are not guaranteed performance products but rather are based on the insurance carrier's current non-guaranteed assumptions that will definitely change over time and market conditions. With guaranteed products, the performance risk is retained by the life insurance carrier. With non-guaranteed products, the performance risk is transferred to the policy owner. However, this risk transfer shift for non-guaranteed products, which commenced in 1979 with the introduction of the first universal life policy, is either unknown or has been completely ignored.

Like all financial products and instruments, all life insurance products have risks, particularly non-guaranteed flexible premium policies. Like other financial vehicles, life insurance needs to be periodically performance monitored, creditably evaluated, and risk managed. Yet all too often these tasks are completely ignored for life insurance. Unlike most writings in category one, the author does not advocate the use of the traditional, constant assumption policy illustrations for evaluating non-guaranteed life insurance products. In fact, all policy illustrations for non-guaranteed products disclaim the predictability of non-guaranteed policy values. Further, non-guaranteed policy illustrations should not be used to compare one life insurance policy to another, which, unfortunately, is common practice among many life insurance professionals and financial planners. Creditable evaluation for a non-guaranteed life insurance product requires actuarial evaluation and related practices that will be described and analyzed in the book.

Besides explaining the basics of understanding life insurance, the risk transfer paradigm shift, and the risks of life insurance policies, this book discusses a dispute defensible process for risk managing life insurance policies. Additionally, it is firmly believed by the author that life insurance should first be selected based on the true, real duration of the need for life insurance. If the need is permanent, the life insurance product type selected should be based first on the policy owner's risk tolerance and, second, on either the need to have increasing death benefit and cash values (to protect purchasing power) or minimum premium outlay. This is opposed to selecting the product *de jure* or "hot product" that does not take fully into account what is suitable for the policy owner based on the owner's risk tolerance and other personal preferences (such as investment objectives, asset allocation, and purchasing power protection).

As a practical matter, all permanent forms of life insurance are internally a "buy term and invest the difference" proposition. Universal life policies annually report to the policy owner the cost of insurance (based on annual mortality rates similar to annually renewable term rates) and the excess premium amounts (based on premium less the cost of insurance and other policy expenses) and earnings credited to the cash account value. As a result, the "buy term and invest the difference" aspect of the policy is readily transparent to the policy owner. However, while certainly opaque, internally whole life product values are calculated actuarially by an identical method utilized by universal life products. Thus, it can be questioned if you are going to "buy term and invest the difference," is it more effective and efficient to do such internally with either a universal life or whole life product-type or externally by actually buying a one-year renewable term life insurance product and investing the difference in mutual funds, stocks, bonds, and so on? Based upon an informed and honest analysis that considers all issues, the tax-deferral, economics of scale, and diversification aspects of the "difference" being invested internally in a permanent life insurance product, most consumers would unhesitatingly conclude it is far more favorable, effective, and efficient to invest the "difference" internally in the permanent life insurance product.

To understand life insurance and its risks, particularly the risk transfer associated with non-guaranteed flexible premium products, it is necessary to examine the basic pricing elements, or building blocks, that comprise every life insurance policy and how these elements interact to produce policy values. To a certain extent, most life insurance textbooks do explain the basic life insurance pricing elements and the rudimentary aspects as to how these elements react. Unfortunately, these textbooks ignore the risk aspects of life insurance and how to creditably risk manage life insurance policies. A discussion of creditable (dispute defensible) policy risk identification and management is a fundamental departure from the typical academic publication. While this writing does present academic justification for the presented materials, it also provides helpful questions and guidelines for acquiring and managing life insurance.

This book addresses basic product suitability, policy performance monitoring, and policy risk management considerations that are quite different (and long overdue) from the three described categories of life insurance publications. The book's objective is to help the reader become more informed in understanding the nature and mechanics behind various life insurance products in a simple, noncomplicated, practical, easy to follow, clear manner. More importantly, this book brings into perspective the risks involved with the most popular types of life insurance policies sold today, particularly the risk paradigm shift triggered by non-guaranteed flexible premium products that, in many cases, precipitated a policy crisis due to risk management inattention. Just as important, the easy-to-apply process to risk managed life insurance policies—that has been utilized in the professional portfolio investment and trust administration industries for years—is presented and described to enable policy owners to take prudent and informed control of these significant assets. Equally significant and valuable to the process of managing life insurance policies is the creditable evaluation of life insurance, particularly non-guaranteed flexible premium policies. The tome explores and analyzes the technique of actuarial evaluation, which applies benchmarking and statistical methods to the probabilities of favorable outcomes with non-guaranteed flexible premium policies. If the described approach of this book sounds like a financial planning and investment management approach to life insurance, it is. The author believes this is a practical, refreshing, different, and unconventional way to handle the topic of life insurance, which is long overdue, to help explain the unexplainable. Hope you find the book interesting, helpful, useful, beneficial, practical, and enjoyable!

Some Background on the Book

The thoughts and ideas expressed in this book are in many ways the accumulation of knowledge from either selling, advising, consulting, writing, speaking, or teaching on the college or university level life insurance over the past 40 years. There are many professional friends and colleagues who have influenced these thoughts either by the author reading their various writings, hearing their presentations and having conversations with them, or by working together or in collaboration. These friends and colleagues will be rightfully credited for their help and influence in the Acknowledgements section that follows. Suffice it to say for right now that the incubation for this book started sometime in 2011 with the conception of the idea of forming an alliance with four nationally prominent practitioners, each from a different professional discipline and perspective, with expertise on the Uniform Prudent Investor Act and trust-owned life insurance to speak at national conferences as a group around the country. In many ways, the gentlemen that comprised this group were kindred spirits that influenced each other. At least, they certainly highly influenced the author. This led to the author developing his own presentation and PowerPoint slide materials that have been used in numerous speaking engagements—both national and local conferences—around the country. The bulk of the material in this book represents the written, elaborated, and fully documented portions of these presentations.

One could say the content of the book is sort of like the time-honored wedding tradition of "something old, something new, something borrowed," without the "something blue." In any event, this writing represents cumulative thoughts on life insurance developed over an entire career and particularly over the past few years. It is written to provide a plain understanding of life insurance for both professional advisers—attorneys, accountants, trust officers, financial planners, and life insurance professionals—and laymen and laywomen who are either prospective policy owners or existing policy owners for personal or business needs, or are decision-making executives and administrators who oversee and have to manage life insurance policies for either public or private businesses or nonprofit and charitable institutions.

With that, it is time to start the journey of "Explaining the Unexplainable."