Medical Economics
SMARTER BUSINESS >> BETTER PATIENT CARE

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The case for investing in life insurance

By Barry James Dyke

Now could be the right time to invest in your own health.

Barry James Dyke

Two years ago, presidential candidate John McCain secured initial campaign financing by using his $3 million life insurance policy as collateral.

In 1980, Doris Christopher used a life insurance loan to launch her struggling kitchen gadget company. In 2002, she sold that company—the Pampered Chef—to Warren Buffett for a reported $900 million.

Even in the midst of the Great Depression, J.C. Penney used a loan against his $3 million life insurance policy to resuscitate his retail stores after the 1929 crash.

By this point in our nation's recession, it is clear that there is no such thing as a perfect investment strategy. As the Dow Jones Industrial Average sits at about 65 percent of its value from 18 months ago, now is an ideal time to learn about the proven benefits, strengths, and versatility of life insurance and annuity investing.

IF IT'S GOOD ENOUGH FOR BANKERS . . .

According to government disclosures, Federal Reserve Chairman Ben Bernanke has a majority of his liquid wealth—between $1 million and $2 million—invested in fixed and variable annuities, which are contracts issued exclusively by life insurance companies that promise guaranteed rates of interest.

What's more, the 401(k) Thrift Plan for Employees of the Federal Reserve System, according to a 2009 first-quarter Fed report covering 22,000 Fed employees, has 75 percent of its assets—that's $3.2 billion—invested in its fixed-income fund, which is invested exclusively in annuity contracts underwritten by major U.S. life insurance companies guaranteeing principal and an interest rate of 5.8 percent.

And this is not a new trend. A Deloitte audit affirms that in 2007 and 2006, Fed employees overwhelmingly chose fixed-income annuity funds over volatile mutual funds.

The nation's large banks invest immense sums of their Tier 1 capital reserves—a bank's most important asset and a key measure of its strength—into permanent life insurance underwritten by major life insurance companies. (See sidebar "Banking on life insurance" for more details.)

Why do banks look to insurance companies for sound investment? Unlike banks, life insurance companies do not use excessive leverage. If a bank has $1 million on deposit, it can lend out up to $10 million to the public. This leverage is called "fractional reserve lending," and it can lead to instability. Indeed, excessive leverage is a major reason why banks are failing today and have throughout history.

However, if a life insurance company has $1 million on deposit, that company may loan no more than $920,000, and usually only a fraction of that. As such, life insurers are 100 percent reserve-based lenders, which makes them stable institutions in down economies.

WHY LIFE INSURANCE?

There are two basic types of life insurance: term life, which is essentially a rented policy for a specified period of time; and permanent or "cash-value" life, which is insurance for as long as you live. While a mix of both types of policy proves valuable for most investors, financial rewards are attainable only with permanent life policies. Following are some of the key benefits of investing in permanent life insurance and annuities:

Safety. Permanent life and annuities, when backed by the general account of a life insurance company, contain financial guarantees, are protected by state guarantee funds, and adhere to strict investment portfolio standards. Enormous losses in today's stock market illuminate the dangers of investing without guarantees. During the Great Depression, when more than 10,000 banks failed, 99.9 percent of consumers' savings in life insurance and annuities remained safe with legal reserve life insurance companies.

Earnings in addition to guaranteed rates. Although additional earnings above guarantees are not assured, most life companies paid additional earnings even during the Great Depression.

Permanent life insurance and annuities are savings systems. A major problem today in financial planning is that 401(k) and mutual fund marketers have successfully blurred the difference between "saving" and "investing." When one saves, money is safe and liquid. When one invests, 100 percent of your money is at risk 100 percent of the time.

When you save through permanent life insurance and annuities backed by the insurance company's general account, your funds are safe, liquid, and tax-favored.

Valuable tax benefits. Savings and earnings within permanent life insurance and annuities grow tax-deferred, and loans from insurance are not taxed as ordinary income. What's more, insurance proceeds are received income-tax-free and, in most cases, estate-tax-free.

Asset protection. Although asset-protection privileges for lawsuits and bankruptcy vary from state to state, life insurance and annuity assets are a favored asset in all states. States with particularly strong asset protection for life insurance and annuities for today's physician include Arizona, Florida, Michigan, New York, New Mexico, Oklahoma, and Texas.

Income-tax-free death benefit. Life is a gamble. The greatest risk we face is the risk of premature death. Protecting those people or causes we love with life insurance is a wise allocation of resources.

When the Reverend Jerry Falwell died in 2007, he left $34 million in life insurance to pay off Liberty University's debts, strengthen that school's endowment, and provide funding for a Thomas Road Baptist Church. Newer annuities also offer additional life insurance benefits.

Professional money management. Savings within a life insurance company are professionally managed to secure the highest rate of return with the maximum amount of safety. You will enjoy diversification by industry as well as by geography.

Unlike some retirement plans, you have access to your money in a life insurance policy through loans and other options. Today, money within a qualified retirement plan (e.g., pension, 401(k), 403(b), IRA) is money in a straitjacket until retirement. Unfortunately, your money is still subject to market risk, inflation, and lost opportunity cost. Not so with permanent life insurance or annuities that are backed by the insurer's general account.

Life insurance and annuities can perform additional economic jobs as well. By attaching riders onto base life insurance and annuities, they can provide additional benefits for disability protection, long-term care, critical illness, and retirement funding.

Life insurance and annuities are wills unto themselves. They are able to accommodate multiple and complex beneficiaries, and can be easily changed without legal costs. At your death, they also bypass probate—thus avoiding legal bills, appraisal costs, taxes, and other expenses common even to midsized estates. States with particularly onerous probate costs include California, Connecticut, and Georgia.

GUIDELINES FOR INVESTING

Life insurance and annuity purchases are some of the most important financial decisions you can make. Do not purchase either of them if you plan to do it for only a year; there are costs associated with any investment, and these are long-term planning tools.

Finally, this author prefers mutual life companies over publicly traded stock-based life insurers (although stock companies can be well-run and offer investors great value). Why mutual companies? A mutual company is not a publicly traded entity and does not succumb to the continuous demands and whims of Wall Street. Mutual companies, although not entirely unscathed, have for the most part dodged the stock market meltdown that has hammered their publicly traded counterparts.

Mutual companies, often criticized for being too prudish and conservative, are now pillars of strength. With a mutual company, a physician is technically an owner in the company and receives the profits of the company through dividends and interest—not stock.

If a mutual company does go public at a later date, its investors can enjoy potential rewards of cash, additional insurance, or shares of the new public company—while still maintaining their initial insurance and annuities.

It is wise to work with an adviser who has expertise not just in life insurance and annuities, but who has a working knowledge of taxes, risk management, investments, and economics. Insure your life as you would insure the economic replacement value of your automobile, home, or practice. Your human life is the greatest economic value of them all—the creator of all property values.

As a general rule, the economic replacement value for life insurance for a physician under 40 is 20 to 25 times his annual income. Physicians who are young will need large amounts of term life insurance—pure death benefit protection. As cash flow improves and debts such as student loans are paid down, purchasing permanent life insurance makes economic sense.

When buying life insurance and annuity products with savings components, purchase products that are backed by the general account of the company first. Why? The general account is the heart of any life insurance company and, by design, one of the safest depositories for savings in America today. By choosing general-account-backed products first, all financial risks are shifted onto the insurance company.

When allocating funds to life insurance and annuities as an asset class, a commitment of 10 to 30 percent of one's portfolio is prudent, since these instruments have stable value and are easily convertible into cash. The nation's large banks consistently invest between 10 to 30 percent of their reserves—hundreds of millions of dollars—into life insurance and annuity products. There's every reason for you to do the same.

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For more than two and a half decades, Barry James Dyke has advised individuals and corporations about financial planning, employee benefit plans, investments, and other economic issues. He is the author of the book The Pirates of Manhattan*, which illuminates the reasons for today's financial crisis and how to protect your assets in the days ahead. Learn more at* www.thepiratesofmanhattan.com.

SORTING OUT THE OPTIONS

Simply put, there are two types of life insurance—term and permanent—and a combination of both types works well for most investors.

Term insurance covers you for a specified period of time, usually from 5 to 30 years, depending upon your age. This, essentially, is rented insurance.

Permanent or cash-value life insurance are essentially one and the same: insurance for as long as you live. You own your life insurance. Permanent life insurance has a savings component and a death benefit. There are three general types of permanent life insurance: whole, universal, and variable life.

Whole life has guarantees in mortality charges and interest, and additional earnings in dividends.

Universal life is more flexible: Interest earned is determined by short-term money rates. Mortality charges increase with age.

Variable life includes mortality charges that can be either fixed or increasing. The savings component rate of return with variable life is determined by the rate of return in the stock market—thus adding significant risk.

An annuity, meanwhile, is a contract issued by an insurance company that offers a guaranteed rate of interest and guaranteed payout options—including an income for life. Annuities are particularly well-suited for retirement savings and are the cornerstone of all pensions.

Unlike a bank or mutual fund, an insurance company must maintain cash reserves equal to the annuity's value. Strict state laws guarantee your principal investment. You won't pay taxes on interest earnings until you withdraw.

BANKING ON LIFE INSURANCE

The following table represents banks' most recent Tier 1 capital holdings of life insurance/cash surrender value (CSV) as of March 31, 2008, and 2009 (as a percentage of banks' total Tier 1 capital). The far right column represents the total amount each bank has invested in its premises, fixed assets, and other real estate. Many banks have more invested in life insurance than they do in all of their hard assets combined. The life insurance proceeds (death benefit) to the bank at the employee's death are about five times the cash surrender value.

Bank	Total Tier 1 Capital 3/31/2009 $$/Billions	Holdings Life Ins/CSV 3/31/2008 $$/Billions	Holdings Life Ins/CSV 3/31/2009 $$/Billions	Life Ins. as a % of Bank Tier 1	Bank premises fixed assets & real estate $$/Billions % of Tier 1
Bank of America	$137.20	$16.74	$18.00	13.12	$13.79 (10.05%)
JPMorgan	$112.44	$7.53	$11.07	9.85	$9.99 (8.88%)
Wells Fargo	$81.03	$5.53	$18.17	22.42	$11.00 (13.58%)
U.S. Bancorp	$15.63	$4.66	$4.83	30.90	$2.80 (17.91%)
BNY Mellon	$13.33	$2.66	$2.72	20.40	$1.47 (11.03%)
KeyBank	$7.81	$2.70	$2.79	35.70	$2.88 (36.88%)

CHART SOURCE: FDIC

THE EQUITY MYTH

There is a great deal of misinformation about permanent life insurance. One common claim, that there is no cash equity in a life policy within the first three years, could not be further from the truth. There are different policies for different applications. Here is an example of a permanent policy from a well-respected midwestern mutual life insurance company with an initial death benefit of $100,000.

$100,000 Life Insurance Death Benefit

Male Preferred Non-Smoker

Participating Dividend Cash Value Life Insurance

2001 Commissioners Standard Ordinary Life Tables

Age	Premium, Annual	First Year Guaranteed Cash Value	Cash Value as Percentage of Premium	First Year Dividend*	First Year Dividend % of Premium	First Year Cash % of Premium
35	$3,166	$1,250	39%	$1,094	34%	$2,344 74%
45	$4,552	$1,805	40%	$1,579	35%	$3,384 74%
55	$6,454	$2,566	40%	$2,245	35%	$4,811 75%

*Dividends are not guaranteed and may be higher or lower than current projections. Actual results will vary. Product may not be available in all states. Check with a duly licensed qualified agent.

BANKING ON LIFE INSURANCE
THE EQUITY MYTH