Whole life vs. indexed universal life

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I give several seminars (CWPP(TM), MMB(TM) and now equity harvesting) to hundreds of life insurance advisors each year. I also send literally more than 140,000 e-mails every week to advisors who receive my e-newsletters. From those who attend my seminars, receive my newsletters and attend my Webinars, one of the most popular questions I receive is: What type of life insurance policy is the best policy to help clients build wealth in a tax-favorable manner for retirement?

Whole life insurance

I call whole life (WL) an "old school" type of life insurance policy. Why? Because it does not lend itself well to new policy designs that can be used to maximize cash values and tax-free borrowing from the policy in retirement.

To generalize, WL is a stable policy and a decent way for clients to build cash for use in retirement. "Stable" is not an exciting term, and I use it deliberately. WL policy returns are tied to the dividends of the insurance company. I usually explain dividends as the return from the insurance company to the policyholder of an overcharged premium.

Essentially, cash that is placed in the life policy will grow well if the insurance company issuing the policy does well financially. WL also happens to be the most expensive type of life insurance policy a client can buy in the early years, which depresses the cash value early on.

My opinion of WL is that it's stable, conservative and clients won't be hurt by using it, yet clients won't get returns that come anywhere near "market rates" of return.

National Underwriter does an annual article, "Illustrating the Actual vs. Illustrated WL returns of several insurance companies" (Dec. 31, 2007), which shows the difference between the illustrated rates of whole life companies versus the actual returns in the policies. It's very good information and shows us the problem with being too aggressive with how we illustrate policy returns. I will pick some numbers from the chart I found to be interesting. The chart takes the current illustrated rates and the actual rate of return from 1987-2007.

	Illustrated rate	Actual rate of return
Northwestern Mutual	7.39%	5.43%
Guardian	7.92%	4.2%
New York Life	7.8%	4.76%

What jumps out at you?

For me, it's the fact that the policies returned approximately 2 percent to 3 percent less annually as the *actual* rate of return, depending on the policy. I'm not sure about you, but that's pretty significant to me.

Indexed equity life insurance (EIUL)

As most of you know, my favorite type of life insurance to build wealth is an EIUL policy. Why? The policy locks in investment gains, which are pegged to S&P 500 (with caps that vary per company by 10 percent to16 percent annually. The client cannot go backwards due to downturns in the market, and they will earn gains that track the market up to the cap. Additionally, these policies have variable loans which can significantly increase the amount of money that can be borrowed tax-free in retirement.

Revolutionary life (my favorite type of EIUL) also has the following features:

- Free long term care benefit
- High cash-value option
- Per 1000 charge waiver

Many advisors have chosen not to sell EIUL because they are too new (the returns in these policies do not yet have a track record). Unfortunately, many advisors have chosen not to even look at them as they just default to the way they have always done business - which means selling WL. I believe this is a mistake and not good client service. If you are in the insurance industry and have not fully researched EIUL policies, you should do so immediately. (By the way, EIUL policies have been around for nearly 10 years).

I'm no genius, but what I can do is figure out what the returns would be in an EIUL policy going back X years using Y variables. Let's take a look at the last 22 years and see how the EIUL policies would have done given certain variables. I will use an annual point-to-point product for all illustrations and the ending value for the last year will end in January of 2008.

The following numbers are what an EIUL policy would have returned with 100 percent participation and a 16 percent, 14 percent or 12 percent annual cap. I'll be your client would have been happy with any of the following returns over the last 22 years:

Participation rate	100%	100%	100%
Cap	16%	14%	12%
Floor	0%	0%	0%
22-year annualized return	9.63%	8.86%	8.00%

I'm not sure about you, but I like the returns from all of the above, using real-world returns from the last 22 years is much better than the "actual" returns of the WL policies.

What if the S&P 500 goes flat? Wouldn't a WL policy be much better? I seriously doubt it due to the locking feature of the policies, but if clients want to hedge their bet, they can use revolutionary life, which can credit 140 percent of what the S&P 500 returns in any given year.

Participation rate	140%
Cap	12%
Floor	0%
22-year annualized return	8.66%

My conclusion - made without emotion or an agenda and based simply on the numbers - is that there is little doubt in my mind that a client has a better chance of generating more cash value in a life insurance policy by using an EIUL policy and revolutionary life, specifically versus a WL policy.

*For further information, or to contact this author, please leave a comment and your e-mail address in the forum below.

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