Strategic Income from Downside Protected Life Insurance

Market volatility is a recurring challenge, with the most recent bull market ending in 2019, ushering in a period of volatility that continues to make clients nervous. For those still accumulating wealth, volatility presents risks and opportunities as retirees face the threat of depleting their portfolios too soon. Exiting the market in an attempt to avoid market losses is not a viable solution, and asset allocation can only do so much, making downside protection essential.

Individuals using life insurance products as part of their retirement planning strategy, however, can either stay in or enter the market with the comfort of some downside protection. For those in retirement, a well-structured life insurance strategy can avoid negative volatility while benefitting from market gains — resulting in a more secure retirement outlook. Table 1, Volatility in Retirement, shows what volatility can do to a retirement portfolio.

Table 1: Volatility in Retirement[1]

Year	Age	Account Balance Start of Year	Income	Post-Withdrawal Balance	S&P Return	Account Balance End of Year
1998	66	$2,000,000	-$110,000	$1,890,000	26.07%	$2,382,717
1999	67	$2,382,717	-$111,100	$2,271,617	19.64%	$2,717,673
2000	68	$2,717,673	-$112,211	$2,605,462	-9.27%	$2,363,862
2001	69	$2,363,862	-$113,333	$2,250,529	-10.53%	$2,013,440
2002	70	$2,013,440	-$114,466	$1,898,973	-23.80%	$1,446,954
2003	71	$1,446,954	-$115,611	$1,331,343	22.32%	$1,628,491
2004	72	$1,628,491	-$116,767	$1,511,724	9.33%	$1,652,793
2005	73	$1,652,793	-$117,935	$1,534,858	3.84%	$1,593,861
2006	74	$1,593,861	-$119,114	$1,474,747	11.78%	$1,648,513
2007	75	$1,648,513	-$120,305	$1,528,208	3.65%	$1,584,046
2008	76	$1,584,046	-$121,508	$1,462,537	-37.58%	$912,848
2009	77	$912,848	-$122,724	$790,124	19.67%	$945,554
2010	78	$945,554	-$123,951	$821,603	11.00%	$911,995
2011	79	$911,995	-$125,190	$786,805	-1.12%	$777,977
2012	80	$777,977	-$126,442	$651,535	11.68%	$727,619
2013	81	$727,619	-$127,707	$599,912	26.39%	$758,232
2014	82	$758,232	-$128,984	$629,248	12.39%	$707,191
2015	83	$707,191	-$130,273	$576,917	-0.69%	$572,920
2016	84	$572,920	-$131,576	$441,344	11.24%	$490,939
2017	85	$490,939	-$132,892	$358,047	18.42%	$423,982
2018	86	$423,982	-$134,221	$289,761	-7.01%	$269,450
2019	87	$269,450	-$135,563	$133,887	28.71%	$172,333
2020	88	$172,333	-$136,919	$35,414	15.29%	$40,830
2021	89	$40,830	-$138,288	-$97,458	28.79%	$0
2022	90	$0	$0	$0	-	$0

[1]Assumes a $2,000,000 initial account balance, income of $110,000 per year increasing by 1% per year.

Insurance Solutions for Market Volatility

Today's insurance market offers three unique products that help mitigate some level of a market downturn while also offering some growth potential. They each have their own unique "value proposition" that may ultimately make one more suitable than the others for a specific client's risk tolerance and other elements of their retirement planning.

- **Whole Life:** Guarantees a positive return each year with modest additional upside.
- **Indexed Universal Life:** Protects against market losses with growth linked to market performance subject to caps, spreads, or participation rates. Account values may decrease due to policy charges in certain years.
- **Buffered Strategies in Variable Life:** Absorbs some market losses before impacting client accounts, with typically higher growth caps than IUL. Policy charges could still reduce account values in years that trigger the buffer.

While clients can position some of their assets in policies that provide downside protection, it could end up limiting upside potentials. These decisions require careful consideration based on the client's risk tolerance and their retirement goals.

Table 2: The Impact of Downside Protected Assets[2]

Year	Age	Account Balance Start of Year	Income	Post-Withdrawal Balance	S&P Return	Account Balance End of Year	LI Distribution	Taxes	Net Income
1998	66	$2,000,000	-$110,000	$1,890,000	26.07%	$2,382,717	$0	$38,500	-$71,500
1999	67	$2,382,717	-$111,100	$2,271,617	19.64%	$2,717,673	$0	$38,885	-$72,215
2000	68	$2,717,673	-$112,211	$2,605,462	-9.27%	$2,363,862	$0	$39,274	-$72,937
2001	69	$2,363,862	$0	$2,363,862	-10.53%	$2,114,833	-$73,667	$0	-$73,667
2002	70	$2,114,833	$0	$2,114,833	-23.80%	$1,611,433	-$74,403	$0	-$74,403
2003	71	$1,611,433	$0	$1,611,433	22.32%	$1,971,095	-$75,147	$0	-$75,147
2004	72	$1,971,095	-$116,767	$1,854,327	9.33%	$2,027,368	$0	$40,869	-$75,899
2005	73	$2,027,368	-$117,935	$1,909,433	3.84%	$1,982,834	$0	$41,277	-$76,658
2006	74	$1,982,834	-$119,114	$1,863,720	11.78%	$1,083,318	$0	$41,690	-$77,424
2007	75	$2,083,318	-$120,305	$1,963,013	3.65%	$2,034,738	$0	$42,107	-$78,198
2008	76	$2,034,738	-$121,508	$1,913,230	-37.58%	$1,194,149	$0	$42,528	-$78,980
2009	77	$1,194,149	$0	$1,194,149	19.67%	$1,429,057	-$79,770	$0	-$79,770
2010	78	$1,429,057	-$123,951	$1,305,106	11.00%	$1,448,692	$0	$43,383	-$80,568
2011	79	$1,448,692	-$125,190	$1,323,502	-1.12%	$1,308,653	$0	$43,817	-$81,374
2012	80	$1,308,653	-$126,442	$1,182,211	11.68%	$1,320,265	$0	$44,255	-$82,187
2013	81	$1,320,265	-$127,707	$1,192,558	26.39%	$1,507,280	$0	$44,697	-$83,009
2014	82	$1,507,280	-$128,984	$1,378,296	12.39%	$1,549,020	$0	$45,144	-$83,839
2015	83	$1,549,020	-$130,273	$1,418,747	-0.69%	$1,408,917	$0	$45,596	-$84,678
2016	84	$1,408,917	-$131,576	$1,277,341	11.24%	$1,420,881	$0	$46,052	-$85,525
2017	85	$1,420,881	-$132,892	$1,287,989	18.42%	$1,525,172	$0	$46,512	-$86,380
2018	86	$1,525,172	-$134,221	$1,390,951	-7.01%	$1,293,454	$0	$46,977	-$87,244
2019	87	$1,293,454	$0	$1,293,454	28.71%	$1,664,867	-$88,116	$0	-$88,116
2020	88	$1,664,867	-$136,919	$1,527,948	15.29%	$1,761,616	$0	$47,922	-$88,997
2021	89	$1,761,616	-$138,288	$1,623,328	28.79%	$2,090,733	$0	$48,401	-$89,887
2022	90	$2,090,733	-$139,671	$1,951,062	-19.95%	$1,561,766	$0	$48,885	-$90,786

[2]Assumes a 35% tax rate, Male, Preferred underwriting, age 45 at policy inception.

Table 2 highlights the client's superior outcome. By taking an equivalent, non-taxable distribution from a life insurance contract after a market downturn, the client maintains purchasing power with a portfolio value that exceeds $1.5MM through age 90. This is crucial in an era of elevated inflation and the spiraling cost of care later in life. However, two key questions remain: How should the strategy be funded, and which product type is most suitable? To match this outcome in a traditional portfolio, the client would need a starting account balance of $2,475,000 to support the desired income stream and end with $1,560,000 at age 90.

With that additional capital requirement in mind, it is then possible to project how much capital the three insurance strategy alternatives, Whole Life, Indexed UL and a Buffered VUL might require to achieve the outcome shown in Table 2.

Choosing the Right Insurance Strategy

While there are many insurance solutions to choose from, the best product will vary depending on the client, their risk tolerance, and the rest of their portfolio. With the three product solutions that are mentioned here, there are some additional nuances to consider based on the age of the client at policy inception.

For a younger client, a VUL that offers indexed or buffered strategies could be the most appropriate. This strategy takes time to develop, and clients in their 40s are ideal prospects because they would have enough time to use traditional subaccounts at policy inception, and then transition to indexed or buffered strategies as they near retirement. For older clients, one of the downside protected strategies might be more suitable since they may need to let the insurance policy mature a bit longer or allocate more capital to the strategy.

Regardless of how those nuances play out, the end result is yet another powerful argument for the increased use of insurance products in the retirement planning process based on their unique risk/reward profile and favorable tax treatment.

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