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Life Insurance Product Trends for the Ultra-Affluent Market

What's Selling and Why

By Wayne Tonning

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Find out what's hot and what's not in life insurance for the wealthy.

THE ULTRA-AFFLUENT MARKET, GENERALLY defined as estates of $25 million and above, has differentiated life insurance product needs relative to the general buying public. This article details trends in ultra-affluent life sales by product type, including commentary on factors driving sales for certain offerings.

M Financial Group is a distributor of life insurance to ultra-affluent individuals and institutions through member firms. The life insurance sales results shown in this article are those placed by M Financial and represent approximately $750 million of annual life sales, exclusive of institutional business (i.e., corporate and bank-owned life insurance). See Exhibit 1 for historical distribution of ultra-affluent sales by product type. [See Exhibit 1]

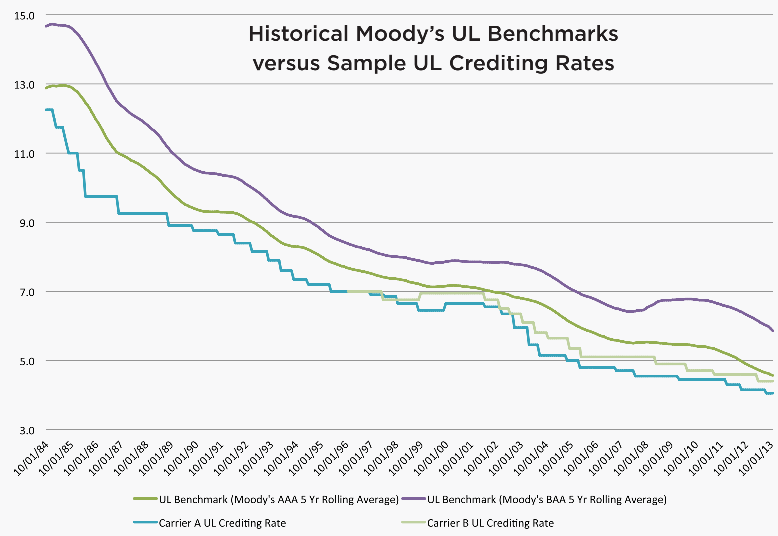
Exhibit 1: Ultra-Affluent Life Insurance Sales by Product Type (Total Premium)

Product Type	2007	2008	2009	2010	2011	2012	2013
Universal Life							
Single Life	29%	31%	19%	13%	16%	13%	11%
Survivorship	8%	6%	5%	7%	11%	5%	9%
Total	37%	37%	24%	19%	27%	18%	20%
Indexed UL							
Single Life	1%	1%	2%	7%	8%	14%	11%
Survivorship	0%	0%	0%	3%	5%	4%	2%
Total	1%	1%	2%	10%	13%	17%	13%
Hybrid Life/LTC							
Single Life	0%	0%	0%	0%	0%	0%	1%
Survivorship	0%	0%	0%	0%	0%	0%	0%
Total	0%	0%	0%	0%	0%	0%	1%
No-Lapse Guarantee UL							
Single Life	17%	14%	24%	25%	13%	20%	17%
Survivorship	6%	6%	12%	10%	11%	10%	8%
Total	23%	20%	36%	34%	24%	30%	25%
Variable UL							
Single Life	19%	21%	22%	20%	16%	23%	28%
Survivorship	7%	12%	6%	4%	8%	6%	7%
Total	26%	33%	28%	25%	24%	29%	36%
Private Placement	11%	6%	7%	8%	9%	4%	2%
Whole Life	0%	0%	0%	0%	0%	0%	0%
Term	2%	3%	3%	3%	3%	2%	3%
Total Single Life	80%	76%	77%	76%	65%	76%	73%
Total Survivorship	20%	24%	23%	24%	35%	24%	27%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

TERM: 2013 ULTRA-AFFLUENT MARKET SHARE OF 3 PERCENT

Most ultra-affluent sales are driven by estate planning, wealth preservation and business continuation needs, which typically require permanent coverage. Consequently, there is a low distribution of term sales (less than 5 percent). This differs from mid-market sales, which are typically driven by family security needs where low-cost term insurance is used as a temporary safety net until retirement funds accumulate to provide sufficient security.

Exhibit 2: Historical Insurer Portfolio Yield Benchmarks and Sample UL Crediting Rates



UNIVERSAL LIFE: 2013 ULTRA-AFFLUENT MARKET SHARE OF 20 PERCENT

Universal life (UL) is a product built on a flexible premium chassis and supported by a crediting rate generally tied to an insurer portfolio yield. These portfolios consist primarily of investment grade bonds and mortgages (Aaa and Baa). As new money interest rates and portfolio yields have dropped, so have UL crediting rates. [See Exhibit 2]

The continued reduction in crediting rates (currently in the 3.5 percent to 5.0 percent range) and insurer restrictions on the amount of new money accepted into the general account (to manage portfolio yield dilution) have resulted in lower UL sales, as the ultra-affluent market considers other product types that may provide additional yield (e.g., variable universal life and indexed universal life). In addition, products that offer lifetime guaranteed coverage (e.g., no-lapse guarantee) are also being sold against UL, as individuals have concerns with continued declining crediting rates and want the peace of mind that comes with guaranteed premiums (assuming premiums are paid on time per the as-sold illustration) and guaranteed death benefit (assuming the insurer is solvent). Bottom line: UL sales have declined from 37 percent of total life sales in 2007 to 20 percent in 2013.

> "With higher prices in 2013, the NLG market share dropped to 25 percent."

It is estimated that more than 80 percent of UL sales come from "performance" or "protection" UL products offering low premium solves offset by low cash values. The low-cost death benefit products are appealing for estate planning, wealth preservation and business continuation applications. UL accumulation sales or products that offer high cash values and/or strong distribution solves have not been popular due to low and uncompetitive crediting rates.

There was, however, a slight uptick in UL sales in 2013 versus 2012, with UL regaining some sales from no-lapse guarantee (NLG) as NLG price increases were implemented due to new/higher reserving requirements. Many firms have been marketing UL by emphasizing:

- Strong current illustrated values where the UL premium needed to keep the policy in force for life (age 120), based on the current charges and crediting rate, is similar to NLG premium
- Strong downside scenario illustrated values with the UL

“VUL is the No. 1 product of choice for the ultra-affluent.”

product staying in force past life expectancy and, in many cases, to at least age 100 when dropping the crediting rate to the guaranteed minimum

- Higher UL cash surrender values as compared to NLG, providing flexibility for changing life events where the living cash benefit may be needed
- Upside opportunity with UL where crediting rates may increase if new money rates and portfolio yields increase in the future (NLG is essentially locked in where it is highly unlikely insurers would improve the guarantee for in-force policies if portfolio yields increase).

The comparison is favorable for UL at the older ages and limited pay scenarios where NLG has had the largest price increases.

NO-LAPSE GUARANTEE UNIVERSAL LIFE: 2013 ULTRA-AFFLUENT MARKET SHARE OF 25 PERCENT

NLG has high demand in the ultra-affluent market due to the appeal of guaranteed price and protection—and NLG’s ability to efficiently meet estate-planning needs where cash value is less important than low-cost death benefit. NLG price increases implemented in 2013 (due to higher reserving standards that went into effect January 1, 2013) drove a fire sale toward the end of 2012, increasing the 2012 NLG market share to 30 percent. With higher prices in 2013, the NLG market share dropped to 25 percent. For many years the NLG market took advantage of low-hanging fruit by rescuing in-force policies with deteriorating performance due to decreased crediting rates for UL or poor equity market performance for VUL. At its height in 2009, NLG held a 36 percent market share. It has since become more difficult to find 1035 exchange opportunities as the available crop has been harvested.

Also of note is the recent introduction of a VUL product offering a lifetime guarantee. This product, which is very competitive in limited pay scenarios, particularly at older issue ages, has generated strong sales, and those results are counted in the NLG market share. In addition to competitive guaranteed premiums, this product also offers relatively strong cash values versus typical NLG products. Premiums may be placed in the separate account without compromising the guarantee. The insurer encourages separate account allocation to manage general account portfolio yield dilution, and the policyowner has an incentive to seek maximum upside potential via separate account returns (e.g., equity market exposure) with the protection of the guarantee.

INDEXED UNIVERSAL LIFE: 2013 ULTRA-AFFLUENT MARKET SHARE OF 13 PERCENT

Indexed universal life (IUL), new to the product lineup, offers a crediting rate determined by the growth in an underlying index (e.g., S&P 500) and subject to a cap (e.g., 12 percent) and floor (e.g., 0 percent). Similar to the overall insurance market, IUL has been the fastest-growing product within the ultra-affluent market with double-digit increases in annual sales through 2012. The popularity of IUL comes from the potential enhanced crediting rate versus UL and IUL’s indirect/partial equity market participation with downside protection via the floor as compared to the exposed volatility with VUL, in particular negative returns. The memory of a negative 38 percent return for the S&P 500 in 2008 still lingers.

IUL market share increased to 17 percent in 2012 and dropped back down to 13 percent in 2013, the same as in 2011. A portion of the decline in 2013’s IUL market share is due to sales being placed with a variable product that offers index accounts.

While IUL may be thought of as an accumulation sale due to the potential enhanced crediting rate, it is estimated that in excess of 70 percent of sales are driven by a low-cost death benefit and an attempt to take advantage of a higher crediting rate assumption to illustrate a lower premium. Determining an appropriate crediting rate assumption for IUL is critical; conservatism is recommended to properly fund the policy and provide a cushion for downside performance.

Another driver of IUL sales is premium financing, which takes advantage of a potential enhanced crediting rate versus low current loan rates. However, while perhaps more popular

> "Survivorship products continue to be popular with the ultra-affluent, consistently garnering market share in excess of 20 percent versus single life products."

outside of M Financial, it is estimated that less than 5 percent of M Financial IUL sales are premium financed. As with the crediting rate assumption, caution and conservatism are recommended with premium financing where performance leverage with the loan is two-sided (i.e., both up and down).

VARIABLE UNIVERSAL LIFE: 2013 ULTRA-AFFLUENT MARKET SHARE OF 36 PERCENT

VUL is the No. 1 product of choice for the ultra-affluent. While ultra-affluent buyers are generally more sophisticated when it comes to investment and are attracted to the potential upside VUL provides, VUL also offers investment flexibility no other product type can deliver.

Most VUL products offer both separate account (e.g., equity market exposure) and general account (e.g., book value investment grade bonds and mortgages) options. A few VUL products also offer index account options. This provides the client ultimate flexibility to reallocate premium over time to any of the three available options as their needs and risk/reward profile change. M Financial has access to VUL products, all of which offer general account options with competitive illustrated performance (relative to other UL products) and one product that also offers index account options that illustrates very competitively versus other IUL products.

It is estimated that less than 50 percent of total VUL premium is allocated to the separate account; approximately 35 percent of the premium in the M VUL product that offers index accounts is being allocated to the index accounts. Notably, many ultra-affluent clients comment that they take risk in their other investments but prefer less risk with life insurance.

As income and capital gains tax rates have increased, demand for accumulation and retirement income sales is expected to increase due to the unique tax advantages of life insurance (i.e., tax-deferred accumulation and no tax liability on distributions when properly structured). While agents have been marketing the tax advantages of life insurance in conjunction with the higher tax rates, it has not generated significant new sales to date. It is estimated that in excess of 80 percent of VUL sales are protection oriented (i.e., low-cost death benefit). Once 2013 tax returns are filed, clients may be motivated to revisit the tax benefits of life insurance, in particular VUL.

PRIVATE PLACEMENT LIFE INSURANCE: 2013 ULTRA-AFFLUENT MARKET SHARE OF 2 PERCENT

Private placement life insurance (PPLI) is a form of VUL where the underlying separate account investments can include non-SEC-registered funds (e.g., hedge funds). The purchaser must qualify as a sophisticated investor (i.e., qualified purchaser and/or accredited investor). PPLI typically involves low case volume but large transactions, typically with premiums in excess of $1 million. While clients are attracted to the availability of nonregistered funds within a tax-advantaged vehicle, PPLI also offers product flexibility where performance via product loads can generally be customized to provide higher early duration cash surrender values.

PPLI market share declined in 2013 to 2 percent. It has been as high as 11 percent (2007, pre financial crisis) and more recently, in 2011, 9 percent. Certainly some of the decline can be attributed to recent investment scandals (e.g., Madoff) and relative underperformance of hedge fund strategies. There is optimism that PPLI sales will grow in 2014 due to the higher ordinary income and capital gains tax rates.

HYBRID LIFE/LONG-TERM CARE: 2013 ULTRA-AFFLUENT MARKET SHARE OF 1 PERCENT

In 2013, M Financial observed a continued decline in the number of insurance carriers offering the type of traditional long-term care (LTC) insurance policies popular in the 1990s and 2000s. Due to mispriced products with actual experience worse than pricing assumptions, many products were discontinued entirely, and of the few remaining products, most experienced significant premium increases.

As such, hybrid life/LTC products (which have been around for more than two decades) are suddenly experiencing a significant increase in popularity among consumers. These linked products address one of the common objections consumers have to traditional LTC insurance: the concern the client may never use the benefits of a stand-alone policy and be left with nothing to show for the premium paid. With a life/LTC product, if benefits are not used for long-term care, the policies instead pay out a life insurance death benefit. More recently, carriers have created life/LTC products that provide even stronger LTC benefits, offer a guaranteed one-time single premium with guaranteed benefits and include a return of premium feature should the client decide to surrender the policy in the future.

The ultra-affluent market has been slow to catch on to hybrid life/LTC. The common objection has been that ultra-affluent clients can afford to self-insure the long-term care risk. Carriers have responded by marketing these products as a "smarter way to self-insure," the general idea being that an affluent client may have funds set aside to pay LTC expenses. If an LTC need should arise, the most likely asset to be used to pay these expenses would be liquid and low yielding, such as a savings account or CD (i.e., designated asset). Marketers have found success by recommending that clients consider repositioning these funds into a life/LTC product. If an LTC event occurs, it is likely the benefit the life/LTC product provides would be approximately three to five times the amount provided in the designated asset. If no event occurred, the client's heirs would receive an income tax-free death benefit approximately equivalent to the value of the designated asset. This asset repositioning strategy appears to be gaining traction with ultra-affluent buyers, resulting in a nearly 200 percent sales growth rate in 2013.

SURVIVORSHIP: 2013 ULTRA-AFFLUENT MARKET SHARE OF 27 PERCENT

Survivorship products continue to be popular with the ultra-affluent, consistently garnering market share in excess of 20 percent versus single life products. Survivorship works particularly well for estate planning and wealth transfer applications. In 2013, survivorship sales increased 25 percent. This was largely driven by intense marketing efforts at the end of 2012 that encouraged affluent clients to take advantage of what was then thought to be an expiring $5M+ gift tax exemption. Many of the trusts funded under this premise in 2012 purchased large life insurance policies in 2013. However, survivorship sales in the future could be dampened by a reduction in the number of estates subject to estate tax as a result of the increased estate tax exemption.

WHOLE LIFE

Competitive whole life (WL) products are not offered within the M Financial Carrier network. Therefore, any WL sales are placed outside of the M network and are not reflected in the sales results noted above.

It is reasonably estimated that less than 5 percent of M Financial sales are WL products. In general, the ultra-affluent enjoy the flexibility, transparency and low-cost premium provided by UL chassis products.

FUTURE ULTRA-AFFLUENT PRODUCT TRENDS

We live in an ever-changing world. Challenges—in the form of low interest rates, economic uncertainty, carrier de-risking and legislative activity—will always have an impact on ultra-affluent clients. As M Financial looks into its crystal ball, this is what we see.

- UL sales will continue to be challenged due to continued downward pressure on general account portfolio yields that support crediting rates. New money rates are still below portfolio earnings even with the recent new money rate increases. In addition, the portfolio yield lag factor will continue to drive down portfolio yields and crediting rates in the near term, even if new money rates continue to increase.
- NLG has lost some of its competitiveness and resulting market share with price increases but will still be in demand based on current pricing. Even with improvements in the economy and strong equity market growth, clients have a lasting memory of the 2008 financial crisis, and most have only experienced downward trending interest rates. So, they will continue to value guaranteed price and protection.
- IUL sales will continue to grow due to the appeal of a potential enhanced yield with downside protection,

"Insurance is an exciting field that requires constant attention and focus."

but not at the high historical growth rates because the product is beginning to mature. One factor to keep in mind is continued downward pressure on cap rates due to continued declining general account portfolio yields that support the floor. While not anticipated, significant reductions in cap rates could have a material negative impact on IUL sales. Abusive sales practices with unrealistic/aggressive crediting rate assumptions and problems with alternative/variable loans could also play a role in dampening enthusiasm for IUL.

- VUL products that offer a full range of investment options (i.e., separate account, general account and index account) are the future trend and will continue to command a majority of sales in the ultra-affluent market. One-stop shopping with flexibility is very appealing to clients.
- Whole life has experienced a recent phenomenon where dividend interest rates (DIR) are either holding or increasing in the generally declining portfolio yield environment. It appears that some mutual carriers are obtaining yield through alternative investments (including affiliated investments), which are performing well with the recent equity market growth. There are instances of favorable DIR movements that are offset by higher underlying charges in the dividend scale not obvious to many buyers (which is a black box). These dividend scales may be at risk if/when equity market performance subsides.
- An alternative investment product has already been built and distributed with more success in the mid-market with less financially sophisticated clients who may not fully understand what they are purchasing. Alternative investments (e.g., commercial real estate, private equity, power & infrastructure and agriculture) can provide additional yield but also carry additional risk and lack of liquidity. In addition, nontraditional product designs must be built to support the alternative investments with a resulting lack of transparency, low cash values and back-ended credits where an exit strategy may not be available if expected performance is not realized. So far, the ultra-affluent have shied away from this product, preferring the transparency and liquid cash values in VUL separate accounts if they want a higher risk/reward product performance profile. But this new product is early in the product cycle; other competitors and product designs are expected and will be evaluated accordingly.
- Potential exists for new money products if interest rates continue to rise. Portfolio yield products will be slow to react to rising rates due to the lag factor and, therefore, there would be an appeal for new money products that could potentially offer a higher crediting rate. One interesting new product that is already available ties the underlying guarantee to the movement in 10-year Treasuries. This product does provide an attractive guarantee if the 10-year Treasury is at 4 percent to 4.5 percent or higher, but 10-year Treasuries are currently just under 3 percent.

Interestingly, new products tend to catch on quicker in the mid-market before gaining traction with the ultra-affluent (e.g., both NLG and IUL). Therefore, mid-market sales should be evaluated as a potential predictor of future ultra-affluent sales.

The economy, legislation, regulatory environment and technology continue to evolve and drive life insurance product innovation. Many of the new trends will be in underwriting, new business process and in-force service, not just product. Insurance is an exciting field that requires constant attention and focus.