

# The Large Case Design Memorandum

## **Consider All The Variables**

This year we've received numerous requests from variable life policyholders to calculate their future policy values assuming no premiums are paid. While this is certainly a viable option for those that have cash flow issues, it may not be the best investment/policy decision long term.

Industry data show most people purchase variable life policies when the stock market is at or near its cyclical peak. Sales drop off precipitously when the market corrects. This is effectively buying high and selling low, a behavior pattern that knowledgeable investors attempt to avoid.

In the context of a variable life insurance policy the negative aspects of this behavior are magnified by the pure cost of insurance. Those of you that understand variable life policies know that the less cash value you have the higher your Net Amount at Risk, resulting in greater economic drag on policy performance. In a perfect world you would optimize the returns on variable life contracts by making larger premium contributions when the market is down, and reducing the annual premiums when the market is up. Unfortunately, we tend to see the reverse behavior which results in missed opportunities for growth and increased internal costs of coverage.

While we do not endorse market timing, it is our opinion that now is a great time to revisit your client's investment and insurance objectives and ask them to consider making a larger than anticipated premium contribution to their variable life contracts.

Historically, the largest stock market returns are achieved in the first 12 – 18 months following a severe contraction. We are not convinced that the current market rally is sustainable. There may be more bad news to come. However, it is equally likely that we may be entering the early phase of a sustained (albeit somewhat muted) recovery and returns in the next 12-18 months could be significant.

For our clients we are recommending the following:

- 1) Make a larger than required premium payment this year.
- 2) Re-balance the portfolio.
- 3) Reconsider death benefit objectives. For clients who are considering a death benefit reduction to save money we advise against this. Dropping the death benefit now may seem like a prudent decision, but if the market recovers significantly clients may find themselves underinsured with no cost effective option to recover the lost benefits.

With respect to new sales: This is the time to recommend variable life! I know clients are skittish about the market but the new crop of variable universal life products with secondary guarantees are excellent choices for younger clients with time to accumulate assets. The only real downside to these products is that the minimum premiums necessary to guarantee the death benefits are higher than competitive fixed products.

Remember, variable life products are not designed to be low cost death benefit products. These products work best when they are over-funded, even slightly. The upside to buying variable today is the likelihood of a sustained recovery in the markets versus the less likely scenario of another crash in the near term. This is a chance for clients to get in low, as they should.

Ask your clients to consider making a large lump sum payment at the inception of the policy with future payments determined by market performance (a valid strategy while the market is still a good bargain). Pile in when the market bottoms, stay away when the market is topping out. Variable products with well priced secondary guarantees offer clients a fantastic opportunity to accumulate assets faster than any other contract if properly managed. The guarantees in these contracts define, in advance, the worst case scenario. This feature was particularly comforting to our clients during the last two years. Those with secondary guarantees were rather calm about the market crash since their death benefits and future costs were pre-defined and guaranteed regardless of market results.

For those clients who currently have variable life contracts without secondary guarantees, consider recommending replacement with a new variable contract that has this feature. This allows the client to make a lateral move from an investment perspective, eliminating the downside risk and retaining the upside potential. Again, this would seem to be the optimal time for this type of change considering current market levels.

We at CPI Companies are in the unique position of being an insurance wholesaler and a Broker Dealer. As such, we maintain wholesaling agreements with most of the top tier variable life carriers. This means that we can process your variable life cases seamlessly in concert with your Broker Dealer. The compensation to you is the same, but the product expertise, underwriting and design services we provide are incomparable.

One final thought: First year compensation on most variable products is higher than fixed products due to higher target premiums. And, asset based renewal compensation trumps traditional renewals in the long run by a large margin. While renewals on fixed products are low and will disappear after ten years, asset based compensation is forever and grows along with the asset base. I know you're not in this for compensation and you only want what's right for your clients. But it doesn't hurt if we all succeed together.

*PS: For future reference- I wrote this on August 10, 2009. The DJIA closed today at 9,337 and the NASDAQ at 1,922.*

- Ron Sussman, CEO

*Securities offered through CPI Capital, member FINRA / SIPC*

*The opinions expressed in this memorandum are those of the author and are intended to provoke discussion and positive change within the industry.*

**At CPI Companies we understand the complexities and demanding nature of the large case life market. Allow us to assist you with your next important case.**

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