



## Variable Life Insurance Products: The Flaw is in the Design, Not the Concept

By: Alan R. Jahde, Esq., LL.M.



On November 6, 2008 the *Wall Street Journal* published an article entitled “Annuities Annoy Insurers’ Holders.” The article relates to losses insurers, and therefore their stockholders, are experiencing because of annuity product guarantees and gimmicks. It is a good example as to why we, in our private practice of law as estate and tax planning attorneys, have not been able to recommend retail variable insurance products to our clients for years. Too many gimmicks that at the end of the day cost far too much and leave the client, who was depending on the product, empty handed and without needed coverage because their policy lapses. While the WSJ article focused on variable annuities, the same criticism applies to variable life products. This is an issue that we fought over with insurance companies for years, to no avail. We finally decided to do something about it. We founded our own insurance company, Castle Re, where we have reinvented insurance products.

Why reinvent? Because the concept of efficient, well designed variable life insurance is a good one. Designed right, variable life insurance can solve more estate and tax problems than any other single estate planning concept available. Like many things that fail, the failure is not due to a bad concept, it is due to placing the concept into a bad product design, inefficient pricing, and a poor implementation plan. The gimmicks we fought against did not improve upon the concept. As we learned, the gimmicks resulted in product failure through lapsation.

Stripped to its bare essentials, variable life insurance is simply a combination of prudent investment management, well managed insurance risk, and tax compliance. Variable life insurance products are protected as legitimate insurance products under the Internal Revenue Code. The tax rules are not complex or difficult to follow. By keeping costs low, not paying huge commissions, and following the tax rules, you can have a planning tool that will provide more estate planning options than any single estate planning tool of which we are aware.

Proper product design and efficiency at the insurance company level will also avoid the other issues noted in the WSJ article. The gimmicks not only directly and adversely affect policy performance, but they create some significant and adverse financial issues at the company level. When a company promises something through a guarantee, someone or something has to pay for that guarantee. The cost to provide the guarantee in a down market can be crippling. That crippling cost is simply passed along to the consumers of the product. In an up market, the cost of the guarantees and gimmicks put a drag on the true rate of return with a result of the overall investment yield being reduced. Over time, even a small reduction in the rate of return will significantly affect how much is available to pay out to the family as beneficiaries.

We chose Bermuda to incorporate our insurance company for many reasons. Bermuda is the third largest insurance jurisdiction in the world. The reasons for this are simple: excellent laws, competent professionals, necessary, but not over regulation, and no local income taxes.

Bermuda also has passed the Segregated Accounts Companies Act (SAC). SAC allows insurance companies that register as SAC companies to create a dedicated segregated account for each policy the company issues. The result is that the investments in the segregated account for the benefit of the insurance policy, by law, can only be used for that policy and not for any other purpose. Those investments are protected from the creditors of the insurance company and from claims of other policy owners. The investments are truly dedicated investments “walled off” and safe from institutional failure, far better protection than “Ratings.”

All premiums paid into the policy, the source of the investment funds, as well as all investment returns, are kept in that dedicated segregated account. Instead of gimmicks and guarantees, money paid in, and money wisely invested, provides the backbone for the policy.

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The benefits of such a simple arrangement are significant. We believe it is the best estate tax planning tool available to both accumulate wealth and then to shift wealth to the next generation. The accumulation advantage is partly due to the ability to invest in a tax favored environment. There is no U.S. income tax imposed on any investment returns within the segregated account. Money can be withdrawn by the policy owner tax free. No margin loans, that can be called, are needed to use the cash in the policy. The investments are also private and asset protected. SAC protects the investments at the company level. The Bermuda Life Insurance Act protects the policy from claims against the insured at the insured's level. The policy also provides an excellent way to invest abroad without all the compliance and tax issues that confront those who have money tucked away in foreign accounts. Bermuda allows Castle Re to custom design each policy it issues for the unique needs of each client. No "off the shelf" policies are ever used by Castle Re.

The philosophy is to keep costs as low as possible and put the policy owner first. Then, adapt the product to the unique needs of each client. Put a great concept into a custom designed product and great things can be done. It is as simple as that. No gimmicks!