

# Buy Term and Invest the Difference (BTID)<sup>1</sup>

3 Different Views



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**Buy Term and Invest the Difference, or “BTID”,** is a strategy which has enjoyed a lot of visibility in recent years. But before you invest, make sure that you understand where a term life plan leads and how it compares to a participating whole life strategy. It may not be what’s best for you.



The Living Balance Sheet, a web-based tool that gives individuals and businesses the information they need to view current financial situations and build efficient strategies for the future.

## What’s the big idea?

Here’s the mindset behind BTID: Life insurance companies invest in conservative, investment-grade bonds and mortgages in order to meet their long-term liabilities. It’s the underlying conservative “returns” on these investments that make up a substantial portion of the gains of a whole life or universal life policy. If your risk tolerance is higher than that suggested by the bond market, then the strategy is that you should acquire cheap term insurance and “invest the difference” between the cost of term and a whole life policy. At the end of the term period (typically 30 years but never longer), the BTID concept presupposes you will have no further use for life insurance and will have accumulated more investment value through this strategy than would have developed through the surrender value of a “permanent” plan of life insurance.

## Does it make sense?

BTID strategies might make sense for you under the following conditions:

- If there is a specific period of time for which you need or desire life insurance, with a near-certainty that you will not require life insurance beyond that period... even if it’s for just a few extra years;
- If the “period of time” does not exceed 30 years;
- If you are age 45 or younger; with enough years to achieve an aggressive investment potential before adopting a more conservative asset allocation, and you are in an age range for which term insurance is relatively inexpensive.
- If you are willing and able to exercise the necessary discipline and expertise both to invest the “difference” and to manage the allocation – through the early “risk taking” years as well as the later “risk averse” years;
- If there is a budgetable difference. Term insurance fulfills an important role in providing needed or desired death benefit at low initial cost. If you lack the financial resources to procure lifetime insurance coverage with the appropriate lifetime (i.e., “permanent”) insurance product, then maintaining a suitable level of term insurance would be the appropriate strategy (presumably without a “difference” to invest).

## Why not BTID?

One argument that's often made in favor of BTID is that times have changed, and that BTID represents a newer, better investment alternative in the world of life insurance. Yet it's precisely because times have changed that a financial strategy based on term life may not be what's best for you.

Consider: the 21st century marks a shift in the paradigm of what a life span "should" look like. People are not only living beyond life expectancy in ever-greater numbers, but they are working beyond traditional retirement age. Having children later. They're changing careers, starting up businesses later in life, starting second families. Their parents, too, are living longer and may be dependent upon them for care and support. At the same time, they may be responsible for providing financial support to dependent children, whether young or adult.

In other words, your financial obligations may not only be more wide-ranging than in your parents' and grandparents' day, but will probably also last longer. The right choice of insurance can play a crucial role in helping you to protect your ability to meet those obligations before and after retirement. For all the above reasons, given the length of time you're likely to need insurance, it is increasingly unlikely that a BTID strategy is going to adequately serve your needs.

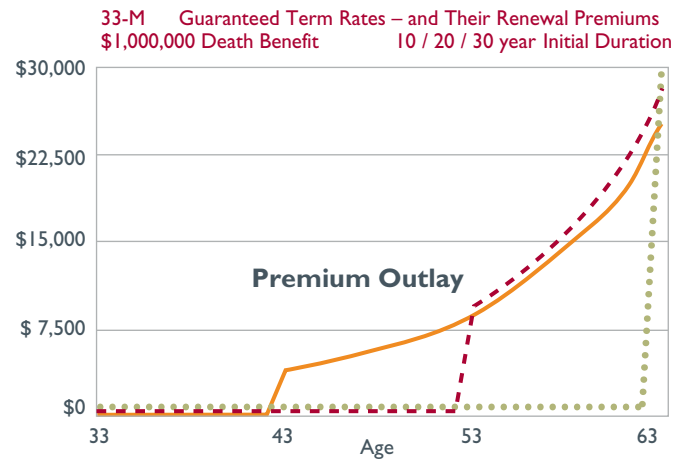
## Take another look at whole life

Following are three examples that illustrate why whole life is likely to be a better choice than BTID. Each one assumes lifetime uses for life insurance and the expectation that you'll want to optimize your retirement income from investment assets as well as a desire to leave a legacy to your family. Should you "buy term and invest the difference" ... or buy permanent life insurance to achieve the same objectives? Let's take a look.

### 1. Look at cost

The following table demonstrates that while term insurance is very affordable (in this example for a healthy, non-smoking 33-year-old male) during the primary premium guarantee period (5 to 30 years), annual premiums escalate rapidly to an *unaffordable* degree once the guarantee period ends. This "fact" is the basis for the BTID approach, but it is based on the underlying assumption that you are absolutely certain you won't want to have coverage beyond the original term of the policy and/or you won't be disturbed by the absence of the coverage once the premium begins its escalation. With more and more people living into their 80s, 90s and beyond, the *real* fact is that

lifetime insurance coverage cannot practically or affordably be maintained with term insurance.



*Rule of thumb:* The increase in the typical guaranteed continuation premium (following the expiration of the initial guarantee period) is more than tenfold. In other words, using our example of the 33-year-old male, the premium that *had* been guaranteed at \$355 would jump to \$3,865 in the 11th year, with subsequent increases annually. Similarly punishing rate hikes apply to other ages as well.

### 2. Look at legacy value

Let's say you are that 33-year-old male and you're seeking \$1 million of coverage. You face a choice between a 30-year term insurance policy with an annual premium of \$939 and a participating whole life policy with an annual premium of \$11,290. You could do a lot with that yearly difference of \$10,351, couldn't you?


Take a look: Say you invested the difference in a portfolio with a net after-tax return assumed as a constant 5.19%. After 30 years, that investment account is worth \$746,997 and your term policy reverts to its underlying guarantee of annually renewable term premiums.

You then continue to invest the full \$11,290 into the account and to pay the escalating term costs out of the investment account. By the time you reach life expectancy, the account is exhausted and your total legacy value is nothing but the term policy's \$1 million death benefit.

On the other hand, using the current dividend scale, if you had invested the \$11,290 into a whole life policy from the start, it could have grown to a death benefit of \$3.2 million by life expectancy.<sup>2</sup>

By the 22nd year of the comparison, the cash value (including the cash value of paid up additions) exceeds the investment value of the BTID.<sup>3</sup> You would have to achieve a constant after-tax return of 5.99% to achieve an age 65 portfolio value greater than the cash value of the participating whole life policy. At this higher assumed constant rate of return for BTID, the legacy value at life expectancy would be \$535,718 remaining in the portfolio plus the \$1 million term policy death benefit. That still adds up to *less than half the legacy value* of the participating whole life policy.<sup>4</sup>

In fact, if you wanted to have a legacy value at life expectancy equal to the participating whole life death benefit (again, at the current dividend scale), you would need to achieve a constant after-tax return of 7.49% (10.7% before tax) throughout your lifetime to accumulate \$2.2 million in portfolio value after paying all term insurance premiums for the \$1 million policy.



**Rule of thumb:** The average compounded rate of return of the S&P 500™ since 1925 is approximately 10.5%. The volatility of that average has ranged from years achieving returns as high as over 47.85% (1954) to as low as -25.99% (1974).<sup>5</sup> If you are seeking lifetime life insurance, BTID may not be as effective a strategy as the synergy of buying permanent forms of life insurance in conjunction with an investment portfolio – unless you are confident of your ability to achieve constant and historically high returns over long periods of time.

### 3. Look at retirement income

Let's take a different view: A somewhat older 45-year-old consumer wants to invest for retirement and desires to maintain a \$500,000 life insurance policy. He seeks an analysis determining whether he's better off with the BTID approach, or if permanent (i.e., a participating whole life policy) would better suit his needs with a total outlay of \$15,000 a year. Here's what he learns:

<sup>1</sup> This brochure is derived with permission from *Life Insurance as an Asset Class: A Value-Added Component of an Asset Allocation*, by Richard M. Weber, MBA, CLU and Christopher Hause, FSA, MAAA, both of Ethical Edge Insurance Solutions, LLC. Please note that deduction of all applicable fees and charges could result in lower performance than shown.

<sup>2</sup> Dividends are not guaranteed and are declared annually by the Board of Directors.

<sup>3</sup> Accumulating at 5.19% after tax.

<sup>4</sup> Assumes 30% tax rate throughout.

<sup>5</sup> Ibbotson 2006 *Stocks, Bonds, Bills & Inflation (S&B) Yearbook (Valuation Edition)*.


### Option 1: Buy Term and Invest the Difference

Accumulated after-tax value @ 65:	\$1,260,578
Interest-only, after-tax income beginning @ 65:	44,120
Portfolio Legacy Value @ life expectancy (Age 89)	1,260,578
Life insurance Death Benefit	0
<b>Total Legacy Value @ life expectancy (Age 89)</b>	<b>\$1,260,578</b>

### Option 2: Buy Whole Life and Invest the Difference

Accumulated cash value and side fund @ 65:	\$1,200,640
After-tax, lifetime income based on immediate annuity:	61,281
Portfolio Legacy Value @ life expectancy (Age 89)	0
Policy Cash Value @ life expectancy (Age 89)	1,437,165
Life insurance Death Benefit	1,681,628
<b>Total Legacy Value @ LE (Age 89)</b>	<b>\$1,681,628</b>

Source: Richard M. Weber & Christopher Hause, *Life Insurance as an Asset Class: A Value-Added Component of an Asset Allocation* (2008).



**Rule of thumb:** Once again, uses of lifetime life insurance synergized with portfolio investments can provide a higher net after-tax retirement income and provide a higher legacy value – while reducing volatility and risk – than using an investment portfolio by itself. If you were seeking lifetime life insurance, you would need to achieve constant and historically high returns of **at least 11%** over long periods of time in order to produce a more favorable result than the strategy of portfolio + permanent life insurance.

## How to Decide?

Speak with your Guardian representative. He or she will work with you to determine the best life insurance strategy for your individual needs. So you and your beneficiaries will be protected, now and in the future.