THE ROAD TO $1 BILLION AUM

FOR DIMENSIONAL FUNDS IN VUL

by Charles Arnold

When you get a cup of coffee and put creamer in it, you still call it a cup of coffee despite the fact it isn't completely black. A good 90% of what you're drinking is coffee, so by majority rule, you call it coffee. You wouldn't find Starbucks selling creamer and then asking customers if they wanted coffee with it because they aren't selling creamer, they're selling coffee. This is a great analogy for overfunded VUL. In the life insurance distribution world, overfunded VUL is being sold creamer first instead of coffee first, which makes little sense. For an overfunded design, around 90% of the annual premium is invested in sub-account funds, with about 10% going towards life insurance coverage and product costs. We need to start selling what the client is truly buying and begin calling it what it is, which is an investment first, and life insurance second. As one of my wholesale friends, Jim Caler with Nationwide, says: "This is like private placement life insurance for the rest of us;" a low-cost structure paired with a world-class investment manager for accumulation.

In order to begin framing the investment sale and talking that language, we need integrate the investment managers into the marketing and sales process. It needs to be a coordinated effort between the investment manager and the insurance carrier at the highest levels, with a well-thought-out joint marketing and distribution plan. Very similar to what the variable annuity market looks like today between carriers and investment firms. Only at that point, can we launch a uniform plan in any meaningful way. Nationwide Financial used to market their VUL under the same marketing "Best of America" campaign they use for their annuities, but they backed off on the life side years ago. A shift back to that mindset for Nationwide on VUL is along the lines of what I'm describing here. Life insurance distribution is mainly third-party distribution, through brokerage general agents (BGAs) servicing the various advisor channels. Once there is alignment between the investment firm and the carrier, select BGAs will need to be integrated into the plan. Preferably BGAs with boots on the ground and who have successfully transformed their business model from a pure processing center, to a marketing organization. It will need to start small, with geographical and advisor channel focus. As with anything, the most difficult step is getting the first few success stories and then trying to build momentum.

There is potential for VUL to become the fastest growing source of AUM for investment firms, which is great from an asset gathering standpoint because VUL is a very "sticky," long-term asset. From the insurance carrier and BGA standpoint, it will help appeal to the investmentoriented financial advisors who don't typically sell life insurance and generate more volume through greater advisor penetration. The challenge will be for insurance professionals to begin talking the investment language and shift away from the traditional fear-driven, death benefit sale. The investment wholesalers can help bridge that gap. (See my related article: Overfunded VUL: The Greed Sale for some further insight as well as Offer Dimensional Funds Tax-Free).

A fund company achieving $1 billion in AUM with VUL isn't as improbable as you might think. I've laid out a basic overview below and linked the relevant baseline illustrations. It is natural to start with a lofty goal such as this, but because this is a "road map", we will build up to it. We also need to take into account there will be different size cases being placed, so to give a more accurate snapshot, I've divided up the size of cases into the below sales mix. It is also going to vary by client age, sex, and underwriting class, but that gets us too much into the weeds on particulars, so for now I went with a standard male client, age 45. I don't show distributions for any of these, but that is something that may be valuable in the field to show. The way a client would think about it is by total investment, so I organized it by total premium they would pay over 5 years, using a 5-pay design:

Assumptions:

25% of cases: $250,000 investment / Initial face: $1.13 million / Target prem $19,949
25% of cases: $500,000 investment / Initial face: $2.36 million / Target prem $39,947
25% of cases: $750,000 investment / Initial face: $3.40 million / Target prem $59,959
25% of cases: $1,000,000 investment / Initial face: $4.54 million / Target prem $79,944

Male client age 45
Preferred non-tobacco
Minimum non-MEC, optimal 2-1 switch
Gross 7% illustrated rate / Net 6.67%
Investment Portfolio: Dimensional Funds at .33% cost

Sample 80/20 portfolio utilized:

Dimensional US Large Value Portfolio: 40%
Dimensional US Targeted Value Portfolio: 15%
Dimensional International Value Portfolio: 15%
Dimensional International Small Portfolio: 10%
Dimensional Global Bond Portfolio: 20%

The way we can look at this is by number of cases placed annually. And from that point, we can determine what particular AUM levels we can hit at any given point down the road. It will also be helpful to determine how many wholesalers will participate, so that we can obtain a monthly case amount per wholesaler to correspond with any given goal. The cash value figures for the illustrations show end-of year numbers, so the figures below are the estimated values 1 year following the sale of the policy:

100 Cases per Year:

End-of Year 1: $11,476,575 in AUM / $4,994,628 target premium
Year 3: $71,848,775 in AUM / $14,983,883 in target premium
Year 5: $187,677,725 in AUM / $24,973,138 in target premium
Year 10: $566,098,775 in AUM / $49,946,275 in target premium

250 Cases per Year:

End-of Year 1: $28,691,438 in AUM / $12,486, 569 in target premium
Year 3: $179,621,938 in AUM / $37,459,706 in target premium
Year 5: $469,194,313 in AUM / $62,432,844 in target premium
Year 10: $1,415,246,938 in AUM / $124,865,688 in target premium

500 Cases per Year:

End-of Year 1: $57,382,875 in AUM / $24,973,138 in target premium
Year 3: $359,243,875 in AUM / $74,919,413 in target premium
Year 5: $938,388,625 in AUM / $124,865,688 in target premium
Year 10: $2,830,493,875 in AUM / $249,731,375 in target premium

To get to $1 billion in AUM at the end of 5 years, there would need to be 533 cases sold per year, for a total of 2,665 cases. To achieve $1 billion in AUM at the end of 10 years, 177 cases would need to be sold per year, for a total of 1,770 cases. This is assuming the sales mix we previously described and the 7% gross annual return. It is important to note that these are lifetime sales, and the values will continue to accumulate for the life of the client, or until they decide to take income, which may not be for 20 or more years. This is also assuming a 5-pay scenario, and any particular client could continue to contribute past that point, if they desired.

In reality we know the number of cases sold per year is going to vary quite a bit, and it will likely start small, with greater success in subsequent years if the program finds legs. It will look more like a staircase as opposed to the linear projections used above. A starting goal may be to have 20 wholesalers participate with a goal of 5 policies each for the first year, which would get us to 100 cases sold. That would be a case every 2 and a half months per wholesaler, which is probably a low-bar, but a bar none-the-less. Let's take a look at it a different way. If we only sold 100 cases total and then completely stopped, what would be the value of those 100 cases in AUM? Using the same assumptions and case-size mix, 100 cases sold today equates to $300 million in AUM 30 years from now.

End-of Year 1: $11,476,575
Year 5: $65,295,825
Year 10: $83,302,025
Year 15: $112,844,275
Year 20: $155,778,850
Year 25: $216,025,500
Year 30: $301,954,500

There are almost limitless combinations depending on a multitude of factors, and Nationwide, together with the distribution BGAs, will need to determine a plan to implement and monitor activity. Joint advisor meetings in regional locations sponsored by the investment firm and carrier is a great way to leverage a large advisor audience and drive lead-generation. Ideally, the investment company wholesalers and general marketing efforts would help communicate this particular story to advisors already utilizing the investment strategies in other client accounts. Most advisors won't be familiar with this style of insurance design, so describing it clearly will be just as important as the investment story itself. As with any mass-advisor, wholesaling story, it needs to be simple, relatable, and repeatable. Emphasis on the simple.

As an alternative, Dimensional Funds does have a Global Moderate Allocation Portfolio available within the product, which could be used at a cost of 51 bps. It is important to have sample portfolios ranging from conservative to aggressive with historical performance figures so the advisor and client can visualize and completely understand the engine under the hood.

A degree of field underwriting will also need to be included with the wholesaling campaign, where wholesalers stress that healthy clients are the preferred prospects, because that is paramount in keeping cost of insurance low and delivering the maximum benefit. As a ballpark, ideal parameter, only high-income clients age 25 to 60 that fall into the top three underwriting classes would be preferable. Clients that fall into the lower underwriting classes would need to make the determination, along with the advisor and BGA, as to if this strategy makes sense for them. Cases that fall under $1 million in face amount should utilize intelligent underwriting, which is Nationwide's version of accelerated underwriting to allow for a more transaction-like feel for the advisor and client.

In conclusion, I wanted to illustrate the asset gathering potential for overfunded VUL and help setup a framework for potential distribution. It is a lifetime product sale that can help clients accumulate wealth in a tax-favored manner for use while they are alive, or to transfer to beneficiaries. It is important for any distribution strategy to have quantifiable metrics to base their sales goals and that was my aim in this quick analysis.