

TWO INVESTMENT OPTIONS WITH UPSIDE POTENTIAL AND DOWNSIDE PROTECTION



Equity indexed life policies and structured notes can be valuable additions to your portfolio.

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With stock market volatility likely to remain high until the COVID-19 crisis ends, many investors, including retina specialists, have become more risk averse. At the same time, bank account, CD, and treasury yields are near all-time lows. In this environment, many physicians may be looking for investment options that provide some upside potential with downside protection. In this article we discuss two options that, if implemented properly, can achieve this goal: equity indexed universal life (EIUL) insurance policies and structured notes.

EQUITY INDEXED UNIVERSAL LIFE POLICY BASICS

An EIUL policy is a type of cash-value life insurance policy, as it has a cash value and investment portion as well as a death benefit. Cash-value policies are also called permanent policies because they do not have a term after which they will expire (as term policies do) and are intended to be kept in place until the insured dies.

There are several types of cash-value insurance, including variable and whole life, for which the cash values grow based on a variety of methods. With an EIUL policy, the cash values are used to implement what's known as a *collar strategy*.

In this type of strategy, the insurance carrier sells call options and buys protective put options on positions it owns. In return, the policy's performance is tied to an index, such as the S&P 500.

Through the collar strategy, the carrier can guarantee policyholders a floor, or minimum return (eg, 0%) that protects them from losses. With an EIUL, if the index the policy is tied to goes down 20%, the cash value does not go down. EIUL policy cash values also have a ceiling, or cap, on the upside (eg, 10%), which means that if the index goes up beyond the

cap, the policyholder will get a portion of the total upswing, capped at 10%.

Because of their upside potential and downside protection, EIUL products have been extremely popular since the Great Recession, with more than \$2 billion invested into new EIUL policies in 2018 alone.¹

Benefits

In addition to the downside protection and upside potential, EIUL policies have the benefit of the cash value growing tax-free and, if managed properly, accessible tax-free. Also, in many states, the cash value is protected from lawsuits by statute.

Risks

As with any investment product, EIUL insurance has risks. One is that EIUL policies are not 100% liquid; in fact, policies generally have a surrender period of 8 to 12 years, during which, if one surrenders the policy completely, a surrender charge is assessed against the cash value. This charge can be avoided by withdrawing some, but not all, of the cash value.

Another risk is the possibility that the insured will not be able to adhere to the designed premium schedule. A policy's size and costs are based on the premium schedule charted out when the policy is implemented (eg, \$10,000 premiums each year for 10 years). A deviation from this premium schedule by the policyholder can result in a significant negative impact on the policy performance.

Finally, because an EIUL policy's cash values are managed by the insurance carrier, there is carrier solvency risk. Thus, using top-rated companies with track records of at least 100 years is crucial.

STRUCTURED NOTES BASICS

Structured notes are hybrid securities, as they combine the features of multiple different financial products into one. Issued by some of the largest banks in the world, structured notes combine bonds and additional investments to offer the features of both debt assets and investment assets. It is estimated that \$2 trillion is invested in structured notes worldwide.

Structured notes are not direct investments; they are derivatives, as their value is derived from another linked asset. The return on the note depends on the issuer repaying the underlying bond plus a premium based on the linked asset, less the bank's fee.

Most structured notes have four common elements:

- Maturity can range from 6 months to many years; most are 3 to 5 years.
- The linked asset is typically a stock, bond, exchange-traded fund, index, currency, or commodity.
- There is a payoff—the amount the investor gets at maturity.
- The investor has a level of protection if the linked asset loses value.

Risks

There are several risks inherent in a structured note investment.

Complexity: Structured notes are complex financial instruments. Investors should understand the reference assets or indexes involved and determine how the note's payoff structure incorporates these in calculating the note's performance.

Market risk: Although some notes have buffers and other protection factors built in to reduce the impact of a bad market, the investor may still suffer a financial loss as with any other investment that is not FDIC insured or principal-protected.

Lack of liquidity: Should investors need access to their funds prior to maturity, they will be forced to sell the note on the open market. Although there may be a buyer willing to purchase it at some price, typically it is at a deep discount to what the note is worth.

Issuer risk: Ultimately, the structured note is only as strong as the issuer. If the issuer defaults, the entire principal could be lost.

WORK WITH THE RIGHT ADVISOR

Both EIUL policies and structured notes can be valuable components of a physician's overall portfolio, especially for investors looking for downside protection with upside potential.

Because these products are complex and contain inherent risks, working with a knowledgeable professional advisor to evaluate the options is always recommended. ■

1. Iacurci G. Indexed universal life insurance sales continue hot streak. InvestmentNews. March 15, 2019. www.investmentnews.com/indexed-universal-life-insurance-sales-continue-hot-streak-78621

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