Ohio National Financial Services®

Whole Life Insurance Protection

Permanent or Term Life Insurance: A Comparison

Debunking the Myth Surrounding "Buying Term and Investing the Difference"

The "Buy Term and Invest the Difference" Question

You've decided to purchase life insurance, and the next step is to determine what kind. Temporary needs are best suited to term life insurance, but how do you know if your need is only temporary? Insurance experts will often suggest that permanent life insurance could be applicable for everyone as the cash accumulation component can provide significant value even after the need for death benefit has declined.

On the other hand, financial pundits and consumer experts have suggested that the cash value potential of permanent life insurance policies is a poor tool for wealth accumulation. **The alternative course most often suggested is to buy term life insurance and invest the difference in premium into the stock market.**

Both approaches will have the ability to provide you with the death benefit protection that you want. There are significant differences as to what options you have at the end of the level term period, and you need to be aware of them. However, the discussion always comes back to what happens with the excess dollars that could be invested elsewhere.

While it is impossible to predict the future course of any investment, we can test this hypothesis through the use of historical data. We know what the equity indexes produced in the way of historical returns. (See S&P 500 Index* returns at right.) We can look at that performance using some basic assumptions to determine how an individual might have seen their assets accumulate over time, either through permanent life insurance or through an investment.

S&P 500 Index
1994-2013

Year	Annual Return
1994	1.32%
1995	37.58%
1996	22.96%
1997	33.36%
1998	28.57%
1999	21.05%
2000	-9.11%
2001	-11.88%
2002	-22.10%
2003	28.49%
2004	10.88%
2005	4.91%
2006	15.76%
2007	5.49%
2008	-37.00%
2009	26.46%
2010	15.06%
2011	2.11%
2012	16.00%
2013	32.39%
Average	**11.12%**

* You cannot invest directly in an index. In this example, the index is being used as a proxy for any equity investment. The returns listed assume dividends are reinvested back into the index.

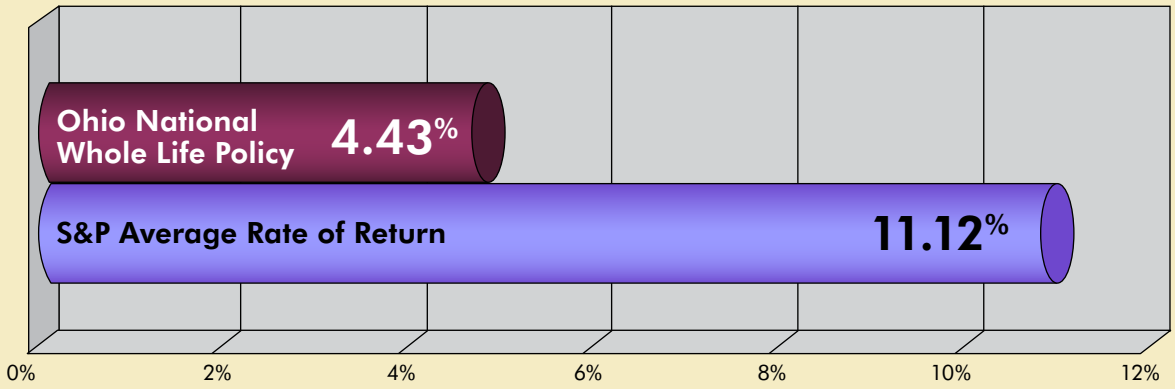
Average Rate of Return vs. Real Rate of Return

Over the 20-year period 1994-2013, the average rate of return for the Standard and Poor's 500 index was 11.12% (see table, previous page). This includes some very good years, the 1990s, and some difficult years, the 2000s. Based on the fact that the return was 11.12% over that 20-year time frame, many investors would believe that the stock market does indeed deliver better long-term returns than other assets.

Over the same time period, a whole life insurance policy* issued by Ohio National would have delivered a real return of 4.43% on annual premiums.

But there's a big difference between *average* rate of return, (adding up 20 years worth of returns and dividing by 20) and a *real* rate of return. The real rate of return assumes an investment at the

Compare the Difference at Year 20



Whole life returns include both guaranteed cash values and non-guaranteed dividends. Returns would have been lower if only guaranteed values had been paid. Similarly, returns available in the stock market include both capital gains and dividends, neither of which is guaranteed.

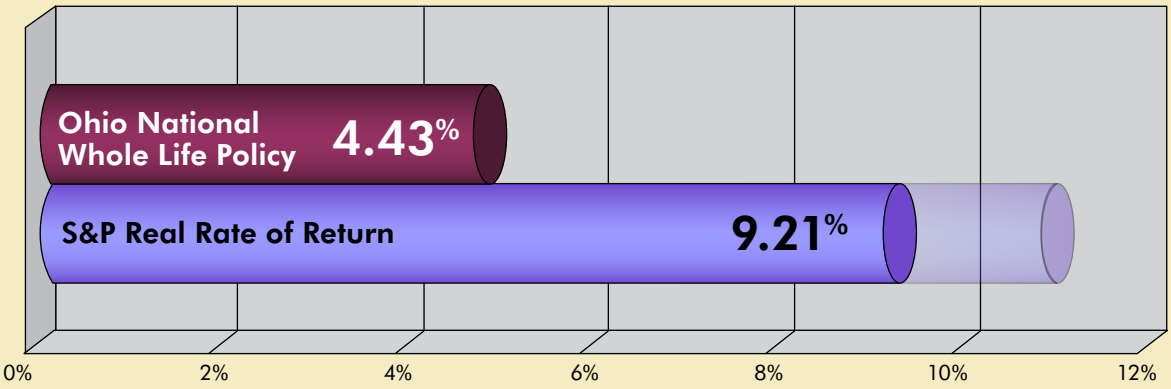
* The whole life policy return used in these examples assumes a purchase of an Ohio National $250,000 EVP whole life policy with historical dividends to buy paid-up additional insurance on Jan. 1, 1994. The insured policyholder was a male, age 45, best class. All premiums were paid on an annual basis and no loans or withdrawals were taken. The EVP policy was replaced with the Prestige Max (Policy Form 06-PW-1/1U) policy in 2008 and is no longer for sale.

beginning of the time period and then tracks it through the ensuing years. At the end of the time period we can calculate what level rate of return would be required to deliver the same value. In other words, real rate of return is the rate of return your investment would have received had it actually been invested over the time period.

Because downturns in the stock market can be magnified over time (if you lose 20% in one year, you must earn 25% the following year to break even), the real rate of return is lower than the average. **Over the past 20 years, the real rate of return was 9.21%,** about 1.90% lower than the average – that's more than a 15% reduction, and far less than what some people might expect from the stock market.

Returns for all assets fluctuate over time and the return quoted for the EVP policy, as well as the S&P 500 index, are accurate only at the 20-year point. Returns would be different if held for longer or shorter periods of time.

Compare the Difference at Year 20



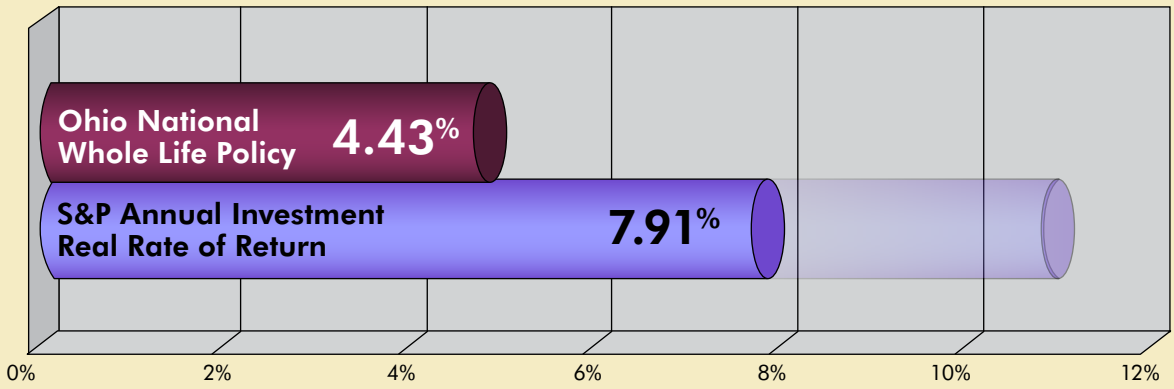
Note that the whole life policy rate of return remains 4.43%. Because the cash value of whole life policies can only increase in value, they never have to overcome the effect of market downturns and therefore have the ability to provide more consistent rates of return than other assets.

Single Payment vs. Multiple Payments

One potentially misleading aspect of advertised investment returns is that they are predicated on a single investment made at the beginning of a given time period. But that's not how most people accumulate wealth. It's also not what happens when somebody suggests buying term life insurance and investing the difference.

Life insurance premiums occur every year, not one time at the beginning of a period. Instead of one payment, if we assume 20 equal annual payments on January 1 of each calendar year, **the real rate of return for our dollars drops from 9.21% to 7.91%.** That's a far cry from the 11.12% previously shown, and is much more representative of what would happen had we bought term life insurance and invested the difference 20 years ago.

Compare the Difference at Year 20



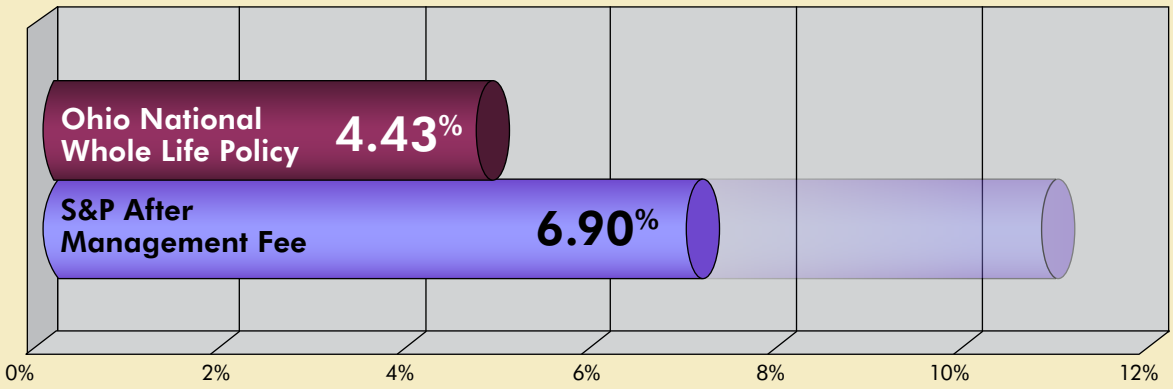
The whole life rate of return had already assumed equal annual premium payments and, therefore, is unaffected. Note that at this point the returns in this example are very similar, but the volatility assumed is substantially higher for the equity investor.

Managed Portfolio vs. Unmanaged Portfolio

The returns discussed to this point assume that our hypothetical individual is able to achieve stock market returns every year on an unmanaged portfolio. Once again, reality says that this isn't a factual situation. At some point, somebody needs to get paid to manage money. Either a mutual fund manager, fee based advisor, stock broker or some other entity will be receiving compensation for money management. **Assuming a 1% annual management fee, the rate of return now falls to 6.90%.**

Why does the rate of return decline by more than 1%? Because every dollar that comes out of the account loses any potential gain it may have had over the remainder of the period. The term used for this phenomena is Lost Opportunity Cost (LOC). LOC tells us that any time a dollar is removed from our savings for taxes or fees, we not only lose that dollar, but we lose all potential growth of that dollar moving forward, forever.

Compare the Difference at Year 20



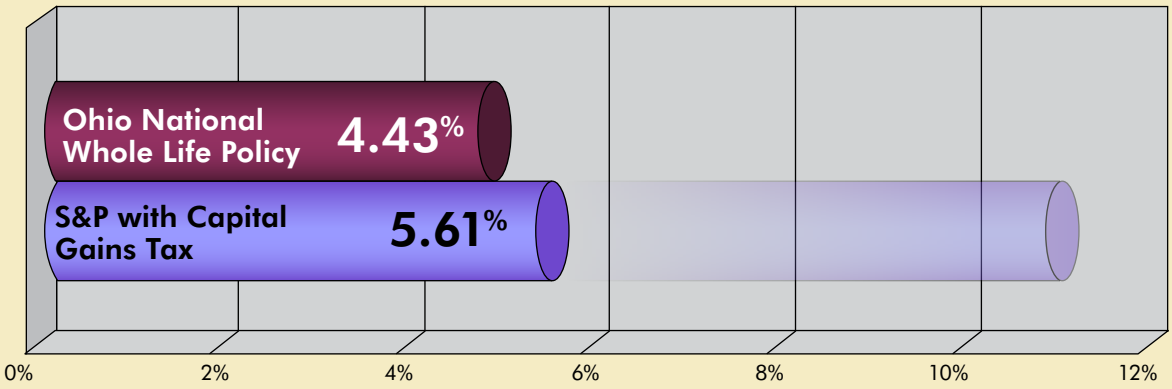
Whole life insurance doesn't have an explicit management fee. The company manages the portfolio of assets together and all costs are included in the larger pricing decisions made when the policy is created.

Taxed vs. Untaxed

At some point, we must consider taxation. Taxation can occur annually, or at specified periods. Ultimately, taxation reduces the amount of asset that can be used.

If the premium difference between a whole life policy and a term policy were in a brokerage account and we assume taxes each year on the gain in the account (taxed at the long-term capital gain rate then in effect), the return would be 5.61%. **That's about half the advertised 11.12% rate of return for the past 20 years.**

Compare the Difference at Year 20



One distinct advantage of life insurance is that it receives certain tax advantages on the accumulation (tax-deferred) and distribution (tax-preferred) of money inside of a policy. While assets accumulated in other vehicles are taxed either during accumulation or distribution, there may not be such a tax with a properly structured life insurance policy. If a whole life policy is surrendered outright, the gains are subject to ordinary income tax.

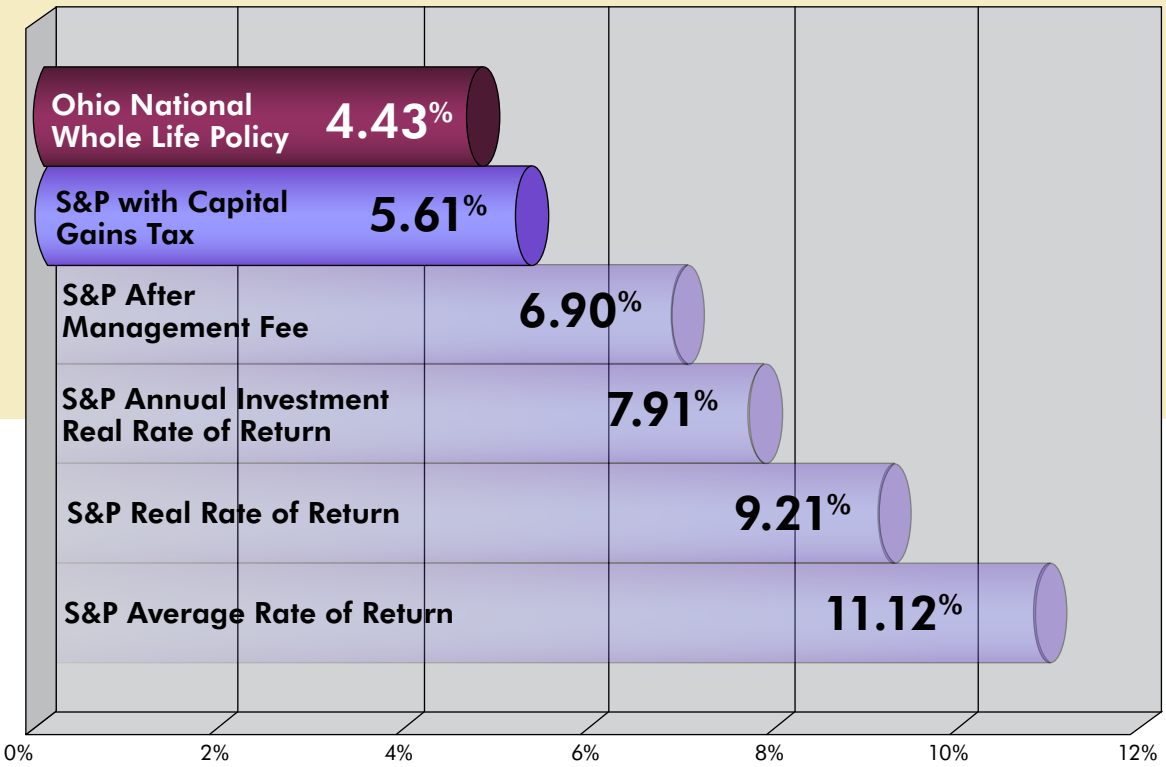
Twenty Years Later

So where did our hypothetical insurance purchaser stand at the end of this 20-year period? In one case, the policy was in force and assets have accumulated inside of it on a consistent basis. These assets were available for the policyholder's use, and could have been accessed on a tax-preferred basis. If the policyholder dies prior to maturity, a death benefit would be paid to the beneficiary of the policy that is greater than the cash value of the policy. In this particular example, no further premiums would be charged for the policy.*

In the other case, maintaining necessary term life insurance coverage up to and beyond life expectancy would be an expensive proposition. **The invested assets have grown, but with a level of volatility that many individuals would find difficult to live with and at a rate that is not dramatically better than what could have been achieved in a whole life policy.**

* Not all life insurance policies are paid-up at age 65. Different policies have different premium paying requirements and may require premiums to be paid up to age 121.

Compare the Difference at Year 20



Debunking the Myth about Whole Life

There is a misconception in investing circles that permanent life insurance, and in particular whole life, is expensive, and will not accumulate assets effectively. Oftentimes the proof is a statement describing the last 20 years of equity returns as being a far superior alternative. If taken at face value, it would be easy to assume that the best protection is term life insurance and the best accumulation would be in equities.

The example in this booklet should help debunk that myth. Certainly, not all 20-year periods will yield the same results, but let's examine the benefits of whole life insurance in this context:

Benefits of Whole Life Insurance

1. Whole life insurance provides you with the **death benefit protection** you want to give your family.
2. As long as premiums are paid when due, the **death benefit can never decrease and the policy can not lapse.**
3. **The value of the death benefit can rise** if a dividend is declared.
4. **The values in whole life insurance will only increase** on an annual basis, eliminating the volatility of returns found in other types of assets.
5. There are **no separate management fees** that reduce the cash value growth in your whole life insurance.
6. The cash values in a whole life insurance policy grow **tax-deferred** and can be accessed through loans and/or withdrawals on a tax-preferred basis.*
7. In the case of a participating whole life insurance policy, most issuing companies are **managed for the benefit of the participating policy holders.**
8. Your state may provide **bankruptcy protection for life insurance policies.**
9. **An optional waiver of premium rider** will ensure that the premiums continue to be paid into the policy should the insured become disabled.
10. There's **no need to requalify** for your coverage based on health.

* Policy must not be classified as a Modified Endowment Contract (MEC).

In today's world, you are looking for safety, security and proven results. Many of your peers have discovered all three in whole life insurance. Whole life insurance has been delivering value to Americans for decades – it is a foundational asset in many financial portfolios.

The guarantees of whole life insurance provide financial certainty in a time of uncertainty, and thereby give a permission slip to invest in potentially higher yielding assets with other money. Additionally, whole life has a performance track record that goes back to 1924 with Ohio National. Through every financial crisis, including the great depression and the great recession, dividends have been paid on our whole life policies. Compared to other, less certain assets, that's an enviable record.

Loans and withdrawals from life insurance policies that are classified as modified endowment contracts may be subject to tax at the time that the loan or withdrawal is taken and, if taken prior to age 59½, a 10 percent federal tax penalty may apply. Withdrawals and loans reduce the death benefit and cash surrender value. ***If tax-free loans are taken and the policy lapses, a taxable event may occur. Consult your personal tax advisor on all tax matters. Past performance is no guarantee of future results.***

The purchase of a whole life insurance policy is a long-term commitment. During the first several policy years, both the guaranteed and non-guaranteed cash value of a whole life insurance policy is typically less than the premiums paid. If a whole life insurance policy is surrendered, its surrender value will not always exceed the total premiums paid. Before purchasing any whole life insurance policy, you should request a policy illustration and carefully compare both the guaranteed and the non-guaranteed elements.

Whole life insurance is issued by The Ohio National Life Insurance Company. Guarantees are based on the claims-paying ability of the issuer. Dividends are not guaranteed. Products, product features, and rider availability vary by state. The issuer is not licensed to conduct business and products are not distributed in Alaska, Hawaii, or New York.

Tracing its corporate origins to 1909, Ohio National markets a variety of insurance and financial products in 47 states (all except Alaska, Hawaii and New York), the District of Columbia and Puerto Rico, with subsidiary operations in South America. We are committed to building long-term relationships with our customers and to providing them with solutions as their needs change over time.

APPROVED FOR CLIENT USE.

Ohio National Financial Services®

Life changes. We'll be there.®

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Form 2832 Rev. 11-14