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T. Boone Pickens is famous as an oilman, corporate raider and energy investor. He is also a graduate of Oklahoma State University (OSU) and an avid supporter of the University and its athletic programs. Reportedly, he has donated nearly $500 million to support various OSU initiatives. About five years ago he had the bright idea of convincing fellow alums to allow the University to buy individual life insurance policy them with the beneficiary being the OSU athletic endowment fund (Cowboy Athletics). Apparently 27 fellow alums signed up for the program, with total death payouts over $300 million.

The University planned to take out a large loan in order to pay the premiums on the policies, and Pickens pledged to pay the interest on the loan, at least initially. This looked like a no-brainer for OSU, and similar ideas have been pitched to other universities and foundations.

But, does it really make sense? The OSU policies were written by life insurer Lincoln National (LN). Since LN is in the business of making a profit in writing life policies, why would anyone think that the aggregate premiums charged for the policies would be materially less than aggregate policy payouts?

Life insurance is an extremely useful and valuable product for many people. If you have dependents relying on your income stream, and you have sizable human capital (future wage income), and you have modest financial capital (financial assets in excess of debt), then you are a good candidate for a life insurance policy. The basic idea is to insure the value of your human capital. The most obvious candidates are people in early middle age with young families. As time passes, the need for life insurance for the typical individual recedes. You no longer need life insurance once any of the following events occurs: a) your children grow up and leave home (you no longer have dependents), b) you approach your own retirement (your human capital becomes small), or c) you build up sizable financial capital.

Of course, there are viable uses of life insurance for some elderly people. For example, suppose you own a private business or property that would be subject to significant estate tax and that you'd like to keep in the family. If you don't have sufficient liquid assets to pay the estate tax, your heirs may have to sell the business or property in order to pay the tax. In this case, it might make sense to buy a life policy with a payout upon your death that covers the projected estate tax. But, this surely is a small part of the overall life business.

Cowboy Athletics

It appears that the appeal of the Gift of a Lifetime strategy to OSA was that it appeared to be self-funding. After T Boone picked up the interest on an OSU loan for a few years, the insured alumni would begin to pass away and policy proceeds would be large enough to cover the premiums.

A related issue was that prior T Boone gifts that had not yet been spent were invested in the T Boone Pickens energy hedge fund (BP Capital Management). The value of the OSU holdings in this fund served as collateral for the loan to pay insurance premiums. While this fund was doing great in 2005 and 2006, when performance deteriorated dramatically in 2008 and 2009 the value of the OSU holdings cratered.

Not only did the value of the collateral decline, none of the insured alum died. With no policy proceeds coming in, the endowment committee was forced to pay premiums directly. After three years and $33 million, the committee pulled the plug and cancelled the policies.

Then litigation ensued between OSU, T Boone, LN and various insurance brokers.

Are there any useful lessons in this saga?

First, while there are many useful applications of life insurance, there are other not-so-useful applications. Second, even though mortality rates are predictable in large samples, you cannot accurately predict mortality rates in small samples. Third, don't try and outsmart experts on their own turf. Fourth, if it looks to be too good to be true, it probably is not true.