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Personal Defined Benefit Plans For the Affluent Market: *The Next Great Life Insurance Sales Opportunity*

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For millions of consumers who need to assume greater personal responsibility for their retirement security, what I'm about to describe to you could be the next great life insurance sales opportunity. But first, we have to answer these questions:

- Is it possible to market a life insurance policy designed to act as a personal defined benefit plan?
- Will individuals for whom retirement plan contribution limitations make it impossible to fund adequate retirement incomes flock to a life insurance strategy that provides a reliable, tax-free income stream at retirement?

I believe that the answer to both questions is a resounding "yes."

In advocating for a personal defined benefit retirement security strategy, I'm providing a framework for life insurers and advisers to look anew at the issue of retirement income funded by life insurance. For those of you who've been around for a while, you'll recall that years ago this concept was very popular. Unfortunately, past initiatives were of-

ten ill-conceived and sometimes misleading to consumers, which led to regulatory scrutiny and an abandonment of the concept by numerous insurers (and their compliance departments).

Today, however, it's time to resurrect the belief that life insurance can be an extraordinarily attractive strategy for boosting personal retirement security for the right market segment: affluent individuals and families who are aware of their future retirement security challenges and want to take action to meet them.

The Target Market: Affluent Builders and Pre-Retired

For millions of affluent American workers with trillions of dollars in assets, employer-sponsored defined contribution plans are insufficient to fund their income needs in retirement. That's because employees earning higher incomes have strict limitations on their plan contributions. In

addition, it's clear to them that the decades-long shift away from defined benefit pension plans, toward non-pension defined contribution plans, has diminished their retirement security because they no longer have a pre-determined lev-

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el of retirement income that is both clearly defined and funded.

Recent research from the Retirement Income Industry Association shows that there are 5,590,000 households in the U.S. categorized as Affluent Builders (ages 35-49) and 4,695,000 households categorized as Affluent Pre-Retired (ages 50-64). Combined, these market segments make up 15% of households and control \$5.8 trillion in assets.

In addition, approximately 70% of Affluent Builders and Pre-Retired agree with the statement, "I am concerned about having enough retirement income." And, when thinking about the premium patterns that advisers can expect from this target market, younger purchasers (35-49) will tend to favor annual or monthly outlays while older individuals (50+) will be inclined to supplement systematic premiums with lump sums.

I believe this target market is ready for the personal defined benefit plan concept funded by life insurance, especially when you consider the introduction and growing popularity of the Roth IRA. Subsequent expansion of this idea has validated the "Roth-like" income tax treatment of the personal defined benefit strategy, in which contributions (premiums) are paid-in after-tax, grow tax-deferred, and are received income-tax-free via loans against the policy's cash value.

Major Advantages Revisited

It's important to consider all the major advantages of a personal retirement income strategy funded by life insurance:

1. There is no cap on the amount of money that can be allocated to this plan. This is important to employees with higher incomes, for whom limitations on plan contributions make it difficult, if not impossible, to fund an adequate post-retirement income. The salary deferral limit for Section 401(k) plans in 2007, for example, is \$15,500, plus another \$5,000 allowed in "catch-up" deferrals for participants age 50 or older.

2. The strategy offers an income tax-free life insurance benefit. This protection mitigates the risk to an employee's family when an individual's future earning capacity is lost due to untimely death.

3. It is not tied to an employer's pension plan or to any plan sponsor. Rather, it is personal, flexible, and custom-tailored to meet the individual's needs.

4. If funded by a variable universal life (VUL) policy, the strategy offers numerous investment choices and significant growth potential.

5. If an indexed universal life policy is selected for funding, accumulation potential is achieved through linking cash value growth to an external index (i.e. S&P 500).

6. Unlike typical interest-sensitive life insurance policies, this retirement income approach has a higher probability of delivering on projected benefits because it can be linked to an administrative system. This system not only monitors annual investment performance, but also informs the policyowner annually about necessary adjustments to the annual contribution (premium), which will keep the policy on-track to deliver the desired retirement income benefit.

The Mechanics

Let's look at a scenario: Ed Smith is a 45-year-old sales executive with an annual salary of \$220,000. Ed and his wife Susan, a stay-at-home mom, realize that because of the cap on how much of Ed's salary may be deferred, his 401(k) plan is unlikely to provide sufficient retirement income.

Ed and Susan understand that their future retirement security is uncertain unless they supplement Ed's 401(k) deferrals with additional after-tax savings. Their adviser presents the concept of a personal defined benefit plan funded by life insurance. The couple like that the income tax treatment is similar to Roth plans and that there is flexibility to meet their changing needs over time. Additionally, they place a high value on the life insurance policy's death benefit. Ed is underinsured and the greater coverage creates more pre-retirement financial security for Susan and their two children.

Finally, Ed and Susan also appreciate the administration system that wraps around the life insurance policy and is designed to keep them on-track to realize their defined retirement income benefit. They understand that investment performance varies and that the money paid into the policy must be adjusted downward or up-

ward as often as annually to achieve their retirement income goals.

When applying for the life insurance policy that will fund the personal defined benefit strategy, the adviser must help the clients, like Ed and Susan, make three decisions: identify a desired annual retirement income, select a retirement age, and select an Assumed Investment Return (AIR).

In addition, the adviser needs to help the clients determine how much life insurance to buy. The purpose of the strategy is not to maximize the amount of life insurance someone purchases based upon a given annual outlay. Instead, the adviser should start by calculating the minimum amount of life insurance that would be required based upon the insured's age, annual outlay, and tax guidelines to preserve favorable income tax treatment. The actual amount to purchase should be above that minimum by at least a modest margin.

Why not purchase the absolute minimum face amount? If the policy is issued at that amount, there will be no leeway to increase premium outlays in the future. Additional insurance capacity must be preserved when increases in outlay are needed to respond to investment performance that is less than the AIR. An appropriate approach is to issue the policy at the minimum life insurance amount plus 20%. This opens up a corridor to take in additional contributions in the future if they are needed.

The key to success is balance. The amount of life insurance should neither be too high, because the costs implied can become a drag on cash value growth, or too low, leaving no flexibility to raise and lower outlays in response to varying investment returns.

As an adviser works with clients on considering this strategy, here are some important questions for the client to answer:

- Are the costs acceptable given that I will be able to access my money at retirement income-tax-free?

- The policy may have surrender penalties that would reduce liquidity, should I need to access my cash value before retirement. Is this an acceptable risk?

- Is the ability to put away larger amounts of money inside a life insurance policy than would be allowed in qualified plans important to me?

Of course, the issuance of a life insurance policy is not automatic and starts with the application. Information on the application, supplemented by reports from attending physicians, leads to an assessment of the applicant's health status. There may be additional underwriting requirements, such as a blood test and/or a medical exam. In addition to completing the life insurance application, the client will need to fill out another form about the administration of the policy. The insurance company (or third-party administrator) must know the income objective, the projected retirement age, and the AIR.

Annual Monitoring, Compliance, and Marketing

One of the most critical aspects of this strategy is the annual monitoring and reporting functions that turn the life insurance policy into what is effectively a personal defined benefit retirement program. It's the basis for achieving good compliance and laying the groundwork for future business using "real-world" sales practices.

Since 1980, advisers have sold universal life products on the basis of policy performance projections made far into the future. It is unlikely that even one of these policies has performed exactly as it was projected.

A steady downward trend in interest rates has wreaked havoc on fixed universal life insurance projections that were based on 30- to 40-year interest assumptions as high as 12%.

Similarly, VUL policies were often sold based upon projected annual investment results of 12%. Market ups and downs — especially in recent years — caused a large segment of VUL policies to underperform their projected results. The consequences? Policy premiums that didn't "vanish" as projected; investment losses on 1035(a) cash value rollovers; complaints against advisers, broker-dealers, and insurance departments; litigation, and arbitration awards to policyowners.

Improper sales practices, poor communications, and inadequate monitoring and administration contributed to these problems. That's why the administration systems must be wrapped tightly around this concept and the adviser must make it clear to the client how changes in interest rates and market performance will affect the plan.

In addition, because some agents had abused a similar concept 20 years ago by neglecting to mention to clients that they were purchasing life insurance, marketing this strategy in full compliance with all sales practice requirements is vitally important. Consumers must understand that life

insurance is an integral part of this approach, that it costs money to own and maintain life insurance, and that there may be limitations on liquidity.

Insurance companies have created their own rigorous compliance standards to ensure that purchasers understand what they are buying. Fortunately, today's Web-based technology enables a uniform approach to marketing across various distribution channels. Advisers can use streaming video, personalized micro sites, and marketing materials integrated with real-time monitoring and dynamic disclosure generation to share this concept with their affluent clients and prospects.

Carriers and producers need to understand that this concept requires careful execution, keeping the consumer's interests first. With that mindset directing our actions, we have the makings of a great new idea for our industry.



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