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INSURANCE PLANNING

Insuring Retirement Capital

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The 48th Annual Heckerling Institute on Estate Planning was held January 13-17, 2014. The Institute provided an opportunity for leading estate planners, attorneys, accountants, trust officers, insurance advisors, and wealth managers to get together and discuss what is most important now as they apply their professional skills to preserving their clients' wealth.

Presenter, Martin M. Shenkman Esq., a CCH Wolters Kluwer contributor and member of their FINANCIAL & ESTATE PLANNING Advisory Board, in his session *Estate Planning: The New Frontier*, addressed planning issues for those with estates between five and ten million dollars. As a result of ATRA's[1] "permanent" single individual federal estate tax exclusion of $5.25 million and a couple's exclusion of $10.5 million (for 2013), individuals whose estates are within those limits may believe that planning should be easy. He pointed out that the reduced importance of the federal estate tax does not lessen the need for planning, it just changes the conversation.

And, what is the conversation for this large segment of today's retiring baby boomers? I submit that it is, for a number of reasons: "Help me preserve my wealth." Consider the following as we address one of the concerns of this important demographic.

- As the year 2011 began, the oldest members of the Baby Boom generation celebrated their 65th birthday. In fact, on that day, today, and on every day for the next 19 years, 10,000 baby boomers will reach age 65.[2] We are now into the fourth year of this deluge of retirees and we can measure the level of their concern by the amount of press that is centered on retirement issues.
- Everyday 10,000 baby boomers question how they can make their retirement assets last as long as they live.
- The Financial Industry Regulatory Authority (FINRA) is issuing this Notice[3] to remind firms of their responsibilities when (1) recommending a rollover or transfer of assets in an employer-sponsored retirement plan to an Individual Retirement Account (IRA) or (2) marketing IRAs and associated services. Reviewing firm practices in this area will be an examination priority for FINRA in 2014.
- The good news of the stock market rise since 2008 (the Dow at 16,409, and the S & P at 1865[4]), has increased the value of retirement assets substantially for many retiring boomers and concern about a correction is in the news.
- Annuity owners whose contracts were issued by Security Benefit Life, EquiTrust Life or Guggenheim Life have cause to worry, as do the intermediaries who advised them, as a result of a suit filed February 11, 2014 (and withdrawn February 12, 2014), accusing these firms and Guggenheim Partners, LLC of fraud.[5] Guggenheim Partners LLC and three insurance companies it controls were accused, in a fraud and racketeering lawsuit, by annuity buyers of concealing the true state of the carriers' finances.[6]

We are likely to find that qualified plans and IRAs are a very significant and important asset in the security plans of this demographic and one which they are very interested in preserving. And yet, their fears grow as they read in their newspapers or online pronouncements, such as the above, that FINRA is concerned that the advice they are getting may be more in the salesperson's best interests rather than in their own, and that someone has questioned the finances of an annuity sales organization. Then they open their weekend WALL STREET JOURNAL and read the column by the well regarded, Jason Zweig, which reports that a sales

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organization is trolling for annuity sales by offering salespeople prizes of Maseratis, BMWs, Range Rovers, and Porsches.[7]

Such news is enough to frighten any individual or uninformed advisor from considering an annuity IRA for a rollover. Fortunately, in spite of the negative news, many advisors and individuals are considering deferred variable annuities (DVA) for their rollover of qualified plans, predominately for their insurance features. This is especially true now that the stock market has been so beneficial to their account values in their qualified plan accounts for the last six years.

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Today's market looks much like the market looked in 1998, except that during that time period the 1998 market had been consistently positive since 1982. This being so, the concept that one should pay extra for insurance on their retirement capital was even more disparaged then than it is today because it had been so long since the market had taken a significant dip. Today's retirees are not so sanguine after having experienced the 2002 and 2008 market dips. So let us take a look at an actual case of one who defied the conventional wisdom in 1998 and bought and paid for insurance for his retirement capital.

Rollover IRA Deferred Variable Annuity Evaluation Process

The following process does not include the steps to take when considering the opportunity to move from one employer-provided plan to another, or to move to, or away from, an employer-provided plan. Such moves require careful analysis of the unique features of the employer plans available and individual circumstances.

In this example in December of 1998, a 62-year old married male is considering rolling over $1,000,000 from qualified plans into a deferred variable annuity (DVA). The decision making process proceeded as follows:

1. Prepare a check list of alternatives to the DVA and their expected costs, such as self-directed (retiree lacks skill and desire); Registered Investment Advisor (RIA) managed (expected cost of one percent, reliance is on the individual or entity and no plan B available).
2. If no acceptable alternatives are identified in Step 1, locate acceptable DVAs and obtain prospectuses to identify insurance features desired by the annuitant, and to identify and evaluate costs.
3. Eliminate unacceptable providers due to lack of top ratings, unacceptable features and/or unacceptable or uncompetitive costs.
4. Identify the strongest guarantees that provide a base of protection to address the risks of market corrections, death, and longevity.

This process identified a highly rated insurance company with a strong non-monetary[8] base line guarantee. The guarantee stipulated that if the $1,000,000 was invested in an annuitant-selected portfolio of equity subaccounts provided within the annuity, the non-monetary $1,000,000 base line would compound at six percent per year, minus withdrawals, until the annuitant's age 83. This guarantee would provide the minimum death benefit guarantee or the actual monetary account value, whichever was higher at the time of death. It also provided that the purchasing minimum base would apply at annuitization, if and when annuitization was selected, but only if the base guarantee was higher than the monetary account value at the time.

DVA Performance

From 1998 to 2007 when the retiree hit age 70 1/2, no withdrawals were requested. The monetary account value stumbled over 2002 and had just recovered to about one million, but the minimum guarantee base compounded to $1.6 million.

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The insurance cost was running at about $4,000 per year. The required minimum distribution of $60,000 was taken for 2007, which meant that the growth of the minimum guarantee for that year would be six percent times the minimum guaranteed base of $1.6 million, or $96,000. This $96,000, minus the RMD of $60,000, resulted in an increase in the minimum guarantee of some $36,000.

It is the task of advisors to prepare retirees to make fully informed decisions, not make those decisions for them. For an advisor to advise a dependent retiree against considering insurance on their retirement capital could be hazardous.

After the market swoon of 2008, it was determined that the account value monetary base was unlikely to ever exceed the guarantee base and that the tradeoff of just taking the smaller RMD and getting that little increase in the guarantee base was not as valuable as taking the greater six-percent withdrawal and letting the guaranteed base stay level at the current $1.6 million. These non-annuitization withdrawals may be continued until the annuitant's age 83, thus maintaining the $1.6 million death benefit until then and getting the higher annuitization factors for the higher age from the income guaranteed minimum. Two things must occur for this to happen. First, the monetary account value must be sufficient to cover the insurance costs being deducted each year, which currently are running at about $5,000 per year and the annuitant must live until age 83. Once the contract is annuitized, the balance of the monetary account and the death benefit goes away. From then on, the annuity contract provisions chosen control the life income and contingent pay out provisions, such as ten- or twenty-minimum payouts that provide for the continuation of the annuity payments should the annuitant die prior to the end of the guarantee period.

As you consider this real life example and the similarity of the relatively booming market conditions in 1998 to the booming market conditions of today, as reported in the fourth bullet above, consider the retiree mindset that may be similar to the one in our example. To trust substantial retirement capital entirely to the benevolence of the equity markets not only subjects our retiree to personal angst, but also to possible never ending criticism from a spouse who has a lower risk tolerance. Today's markets have been good to our 10,000 retirees per day. They may be surprised by the good fortune of their retirement plan account values and may come to define it as "important money." If so, they are likely to insist on a plan "B" from their advisors. Yes, these plans are complicated and, because of that, you will most often find them offered by commissioned agents. To offer these plans, to know and to be able to communicate their pros and cons, to know and to be able to communicate how their guarantees work to not only the retiree but also to their other advisors who may be skeptical takes an educated and empathetic professional agent. Look for the properly licensed commissioned sales people who make it their business to study and keep up with the ever changing deferred variable annuity market. These equity licensed professionals are acutely aware of the SEC, FINRA and industry regulators, as well as the retiree's other advisors who will be asking "Is this product in the best interests of this retiree?" It is not something that can be communicated adequately over an 800 number or be offered by low-load providers who usually market their products based on simplicity. Most often these products do not offer base line guarantees to address equity market declines, provide increasing death benefits, or the possibility of increasing retirement income.

Is Insuring Retirement Capital Worth It?

The insurance companies have been asking the same question and have learned that their pricing

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prior to the 2002 and 2008 market swoons was inadequate. In order to address the issue of unprofitable guarantees, insurance companies now offer more limited guarantees at higher costs and with more limited investment options. Existing contract owners have been offered buy-backs of their annuities by some insurance companies offering to pay significant amounts over the contract's existing account value in order to reduce the insurance company's liability under the contract.[9] Buy-back offers are troublesome to the SEC and FINRA, fearing what may be good for the insurance company may not be in the best interests of the contract owner.

Conclusion

Using an annuity contract to provide insurance features addressing the risks of equity market underperformance, death during a market swoon and longevity, to retirement capital today is a judgment call based upon the individual retiree's facts, circumstances and frame of mind. It is the task of advisors to prepare retirees to make fully informed decisions, not make those decisions for them. For an advisor to advise a dependent retiree against considering insurance on their retirement capital could be hazardous.

We can expect a good deal of press coverage regarding the use of deferred variable annuities to offer varying degrees of insurance features for retirement capital. However, the best, most credible, information will be contained in the current prospectus and contract language of each issuer. There is much information regarding what to look for within these documents via the web sites at SEC.gov, FINRA.org and intelliconnect.cch.com. Advisors should not be surprised when their retirees wish to consider a deferred variable annuity to hold retirement capital. Insurance agents offering the product should ask and encourage clients to have a trusted attorney, accountant, trust officer or other advisor in attendance when they review the pros and cons of a product with retirees. Having another professional available to ask questions and review all documentation will be beneficial to all concerned. If the retiree is able to articulate why he/she has chosen a DVA, what the extra costs are, and that the extra costs provide benefits that they value and are happy to pay for will be important to all concerned.

The question of how to risk-manage retirement capital for this very large demographic group was described by attorney Shenkman in his Heckerling presentation as probably the most important planning conversation advisors are likely to have with their retiring clients for the next 19 years.

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ENDNOTES

1 American Taxpayer Relief Act of 2012 (P.L. 112-240)(ATRA).

2 http://www.pewresearch.org/daily-number/baby-boomers-retire/

3 FINRA Regulatory Notice 13-45 issued December 30, 3013.

4 WALL ST.J. April 18, 2014, page C1.

5 http://www.thewpi.org/pdf files/whitmore.v.gugenheim.complaint.pdf U.S. District Court, Northern District of Illinois, Eastern Division.

6 *ibid*.

7 WALL ST.J, Saturday/Sunday, February 15-16, 2014, Business & Finance, pp B1+B9, *The Intelligent Investor, Who is Training Your Retirement Navigator?/Think Before You Roll Over* by Jason Zweig.

8 Non-monetary means that it is not a cash account that can be withdrawn, Rather, it is a calculated amount that provides the minimum death benefit amount and the minimum amount to be applied to the purchase of the annuity income if the guarantee exceeds the actual account value.

9 WALL ST.J, Saturday/Sunday, February 15-16, 2014, Weekend Investor|The New Basics, page B8, *Surrendering an Annuity* by Kelly Greene.

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