

The Role of Fixed Indexed Universal Life Insurance as a Retirement Income Tool

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There would have been virtually no need for Fixed Indexed Universal Life if it had existed in the 1760s, when life insurance was first introduced in North America. One of the major attractions of FIUL – the ability to accumulate cash for tax-efficient retirement income planning – would hardly have been necessary, inasmuch as the average life expectancy was 42 years.

Over the next century, life expectancy in the US rose by only five years to 47. Today, it is 78, but this figure is somewhat misleading. Men who reach the age of 65 can expect, on average, to live slightly past 80. Women who achieve the same milestone are prone to live nearly two more decades. In effect, men and women who retire at age 65 will likely need to produce income from their savings for another 15 and 19 years, respectively.

This is a justifiable source of concern for many Baby Boomers. The Benefit Research Institute's 2011 Retirement Confidence Study indicated that more than half of Boomers are concerned about outliving their retirement savings. According to an April 2011 Associated Press poll, 89 percent of the 77 million American citizens born between 1946 and 1964 are not strongly convinced that they will be able to live in comfort in their later years.

Moreover, close to 44 percent of this major demographic expresses little or no faith that they will save sufficient money by retirement. One in four does not expect to ever retire.

These survey numbers may actually understate the retirement income challenge facing the Baby Boom generation, when we consider that:

- Virtually all agents and financial advisors have worked with clients who (a) underestimate what their expenses will be over the course of retirement, (b) fail to take into consideration the full impact of taxes and inflation, and/or (c) overestimate the income that their investments and Social Security will generate;
- Even though, according to research from the St. Louis Federal Reserve, the savings rate among US households has been rising since 2008, it is still only half of what it was in 1980;

- Total household debt remains unhealthily high at close to 114 percent of after-tax income, according to *The Wall Street Journal*; and The Federal Reserve's latest triennial Survey of Consumer Finances (2009) shows that household wealth has declined since 2008 and that average retirement savings are barely in the six figures. Median retirement savings are considerably less.

For agents who are adept at using FIUL as a retirement income solution, the boomer generation's need for a reliable, long-term income source represents a sizeable market opportunity. Nevertheless, guiding retirees and near-retirees through the process of adopting FIUL can be difficult, as many individuals in this age group are unpleasantly surprised when their financial situation is examined in detail. Regardless of whether an agent or FA has a close and trusted relationship with retirement-age individuals, it takes considerable tact to break the news that their savings may not provide the quality of life they expect. Apprising clients that they may conceivably run out of money requires an even more delicate discussion.

We should quickly note that these challenges are not confined to households at the lower end of the salary spectrum. It is not unusual in our industry to encounter solidly middle income boomers who have a home mortgage, equity loan or other outstanding debt. Indeed, slightly more than 50 percent of Americans who retire in their late fifties or early sixties continue to have a home mortgage, as do approximately 35 percent of those who retire later.

A 2007 study by the Urban Institute indicates that individuals in the middle income range commonly begin to see a progressive decline in their wealth near age 70. Given the average life span of US retirees today, this normal decline coupled with unanticipated outlays for emergencies or health-related interludes can abruptly compromise the longer-term income prospects of even "financially secure" households.

For a sizeable middle-income segment of the boomer demographic, FIUL can help to address these challenges.

FIUL's Applicability to the Retirement Income Market

FIUL can be an attractive option for households that seek both a death benefit and the ability to augment retirement income. It offers:

- A death benefit that is income tax free
- The ability to use fixed-index crediting methods to accumulate cash value that can be converted to a tax-free retirement income stream
- Interest gains that can be enhanced by higher potential market results tied to indexed returns
- Protection from down markets, as all prior interest gains are locked in
- Income tax-deferred growth on interest gains

Among the three main universal life products – fixed, variable and fixed indexed – FIUL arguably delivers the most compelling mix of attributes for the majority of near-retirees and retirees. Fixed universal life is considered to have lower risk than FIUL and variable UL, as its interest crediting return is based upon the overall investment portfolio of the issuing insurance company. The trade-off is that the interest crediting return is expected to be relatively low, as most insurance companies populate the majority of their investment portfolio with relatively safe bonds.

Variable universal life is the riskiest because the interest crediting return is usually tied to the performance of an actively-managed fund or funds. The interest crediting return has the potential to be superior to that of FIUL or fixed UL over time, but the downside potential also is greater. The crediting of FIUL is normally aligned with an index, such as the S&P 500. As a result, FIUL tends to exhibit lower risk and less upside potential versus variable UL but possesses a higher risk/return profile than fixed UL. In essence, FIUL offers the relative stability of a fixed UL but with the possibility of more favorable returns — while providing guarantees, flexibility, liquidity and a minimum guaranteed interest crediting rate.

Customers on the very conservative and aggressive ends of the risk tolerance spectrum may be best served by fixed and variable ULs, respectively. FIULs are generally more appropriate for the middle group of customers that seek a more favorable return than a fixed UL but do not wish to subject themselves to the degree of volatility associated with a variable UL. Our experience is that retirees and near-retirees who consider themselves risk-averse but wish to reach for a higher level of retirement income tend to gravitate to FIUL. It appears to us that this group represents a substantial majority of the retirement income demographic.

Once an agent or FA helps a customer choose an appropriate universal life product, there is still a need to select a credited interest rate illustration that best suits the customer's situation and goals. This must be done with great care, because the illustration sets the future expectations for the customer. Comparing FIUL products requires agents and FAs to understand how the insurance company determines its current illustrative crediting rate. Optimally, the insurance company should offer a set formula that enables an advisor to explain clearly to a customer how the current illustrative crediting rate has been determined. Customers can lose confidence if they sense that the crediting rating process is prohibitively complex or arbitrary.

Addressing the Two Major FIUL Markets

There are two broad markets for agents and FAs who appreciate the potential of FIUL as a retirement income tool. One, obviously, is the personal market. Here, the most salient selling points are increased cash value control; enhanced policy accumulation potential; tax favored retirement income; and a flexibility that allows people to manage their policy to meet evolving needs and changing market conditions.

FIUL also can be a highly attractive offering for the business market. For this constituency, the key attraction is that FIUL can provide strong cash values that are accessible for retirement planning, as well as reserve or emergency funds for business purposes. It is also potentially well-suited for key person insurance, deferred compensation and executive bonus programs.

In the personal market, it is often reasonably simple to establish the customer's trigger point, which generally centers on a desire for supplemental retirement income and a death benefit. The business market, however, may require the agent or FA to identify a specific application for FIUL that can improve the business owner's operations or address some other business need. In many cases, an application may not be apparent to the owner without an exploratory discussion. It can be helpful for an agent or FA to ask questions such as:

- Can you envision a situation where the income generated by FIUL can help you pay off a business operating loan or other business debt?
- In regard to your succession plans, would it be useful if FIUL could help you fund a cross-purchase or stock redemption buy/sell agreement?
- Are there key managers or employees whose death could result in a substantial economic loss for the business? Could FIUL provide you with a cost-effective and novel means to provide executive bonuses, wherein you pay the premium on life insurance policies for selective individuals but deduct the premium as ordinary business expense?
- Would FIUL enable your business to offer selected employees non-qualified deferred compensation, in which you own the policy and pay the premiums but can use the income it generates to pay an employees' retirement benefits?
- Have you explored using FIUL as a component of a defined benefit plan to help supplement future retirement income streams?

New Kid on the Block

Among its universal life counterparts, FIUL is the “new kid on the block.” As a result, many prospective customers are not familiar with how it works or what it can achieve on their behalf. As with selling any other insurance product, the most effective way to introduce FIUL to customers is to ask them first to articulate their financial needs and then describe how various FIUL features address those needs. More than 70 million members of the Baby Boom generation are expected to transition into retirement in the next decade and many of them will have retirement income concerns. We believe a large number of these individuals will be attracted to FIUL’s ability to lock-in enhanced index gains in a tax favorable manner, without the level of volatility associated with variable products.

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