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The Facts of Life *and Annuities*

LIMRA

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The Facts of Life and Annuities

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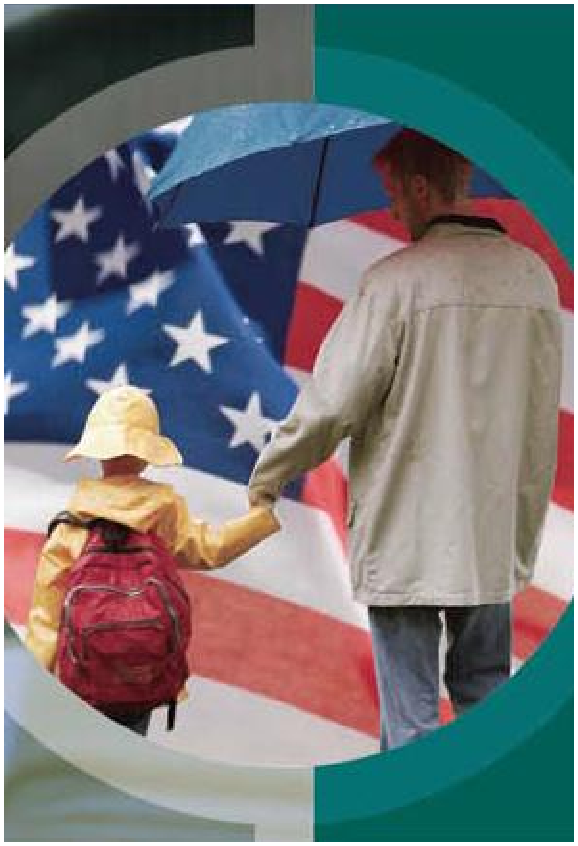


The Facts of Life and Annuities

The near collapse of the global financial markets in 2008 and the ensuing credit crisis has left our world remar ably changed. We now live in a time of government financial oversight and the uncertainty of how to unwind trillion dollar stimulus programs. Trust and confidence in the financial system — including, regrettably, life insurance companies was severely sha en, and has yet to show sustained improvement. Consumers want reassurance and information from companies. Congress and policymakers are calling for widespread changes to our financial regulatory system and possibly new taxation. If there were ever a time for our industry to focus on communicating our fundamental values, surely that time is now.

Insurance products offer families the financial security they need at crucial times in their lives when a loved one dies, or when they retire. These products enable families to survive financially after the death of a wage earner or stay-at-home parent, or even to pass along a lifetime of hard wor to children or a charity. In addition, many of the 76 million baby boomers will rely on their assets in fixed and variable annuities to help maintain their lifestyle in retirement.

Without these financial services benefits, the additional burden on society would be tremendous. More families could lose their homes, or turn to state and federal government to provide the financial support they currently receive from life insurance products. Policyma ers since the earliest days of the modern income tax have recogni ed the value that life and annuity products provide, and ac nowledge that value through special tax treatment.

How do we quantify this value and communicate it to others LIMRA has created The Facts of Life and Annuities for member companies. We hope that you and others in your company will use these facts as you educate people through speeches, articles, presentations, and other means about the value of life insurance and annuities.

10 Key Facts

1. Life insurers paid out nearly 59 billion in death benefits and more than $65 billion in annuity benefits in 2009.
2. Seven in ten U.S. households own life insurance.
3. Fifty-eight million, or half of U.S. households say they need more life insurance.
4. Following the September 11 attac s, the Victim Compensation Fund valued the future earning potential of victims at nearly 16 times income.
5. Most new and existing individual life policies are permanent rather than term insurance.
6. Three in four owners of permanent life insurance and four in five owners pf non-qualified annuities are middle to lower class.
7. Owners of life insurance say they purchase insurance to cover burial and final expenses, as well as for income replacement.
8. Individual life insurance owners plan to use that insurance, more than any other source, to provide for their families in the event of their premature death.
9. One in five retirees uses individually-purchased annuities for income.
10. Nearly nine in ten new deferred variable annuities are sold with some type of guaranteed living benefit (when available).

Life Insurance Ownership Is Widespread, But Inadequate

Seven in ten U.S. households have some form of life insurance coverage, yet they also admit they need more.

Fact Seven in ten U.S. households own some type of life insurance. Nearly half of U.S. households own individual life insurance.

Ownership by Household Income

Household Income	Individual	Group	Any
Under 35,000	31	18	42
35,000 – 49,999	40	44	66
50,000 – 74,999	45	56	79
75,000 – 99,999	47	70	85
100,000 and over	56	66	86
All households	44	49	70

Source 2010 U.S. Life Ownership Study, LIMRA.

Fact The average U.S. household with life insurance owns enough to replace 3.5 years of income. This measure is consistent across all income groups.

Mean Coverage by Household Income

	Individual	Group	Any	ears of Replacement Coverage
Under 35,000	67,700	68,600	79,900	3.8
35,000 – 49,999	116,900	81,900	133,400	3.1
50,000 – 74,999	201,700	127,000	213,600	3.4
75,000 – 99,999	281,000	150,300	295,900	3.4
100,000 and over	504,000	273,500	517,500	3.9
All households	267,300	165,300	279,900	3.5

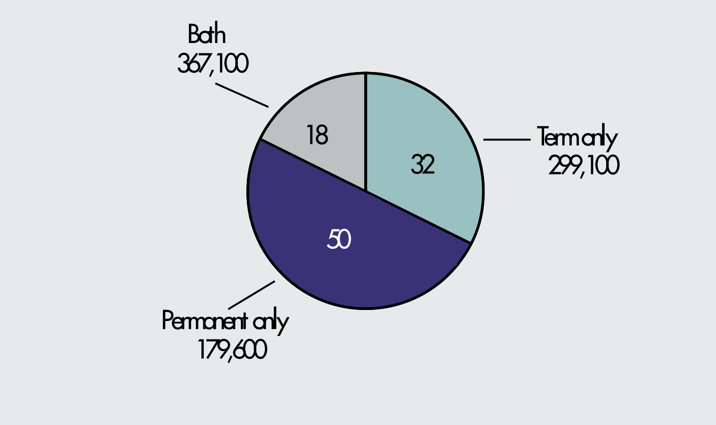
Source 2010 U.S. Life Ownership Study, LIMRA.

Fact Fifty-eight million U.S. households (50 percent) believe they do not have enough life insurance.

Source 2010 U.S. Life Ownership Study, LIMRA.

Fact Households that purchase a combination of both term and permanent insurance have better coverage than those that rely only on either term or permanent policies.

Amount of Coverage by Type of Individual Life



Source 2010 U.S. Life Ownership Study, LIMRA.

The Victim Compensation Fund paid out 6 billion to nearly 3,000 families of those illed in the September 11 attac s on the United States. Compensation amounts ranged from 250,000 to 7 million. The average award for a death claim exceeded 2 million.

The average claim valued the future earnings potential of the victim at nearly 16 times annual income. After life insurance and other offsetting factors, the future earnings value was more than 11 times income. The average victim had life insurance coverage of 2.9 times their income. Without life insurance, the government would have paid out an additional 1.5 billion, or 25 percent more.

Source Final Report The Special Master for the September 11th Victim Compensation Fund of 2001, U.S. Department of ustice, and LIMRA analysis.

The U.S. Armed Forces increased the life insurance it ma es available to soldiers who die in combat or in combat-related situations. On September 1, 2005, the maximum Service-members Group Life Insurance coverage increased from 250,000 to 400,000. The change was made retroactive to October 7, 2001.

Source *Death Benefits, Insurance Increase for Service-members*, American Forces Press Service, uly 7, 2005.

Most Individual Life Insurance Policies Are Permanent

While term insurance has increased in popularity during these difficult economic times, the majority of individual life purchases are permanent, such as whole life or universal life.

Fact Most individual life insurance policies in force are permanent rather than term.

Individual Life Insurance Policies In Force
by Product Type

Product Type	Percent of Policies
Whole Life	48
Universal Life	18
Variable Life	
Variable Universal Life	5
Total Permanent	71
Term Insurance	29
Total	100

less than 1 2 of 1 percent.

Source 2009 Annual Individual Life Insurance Sales and In-Force Survey, LIMRA, 2010.

Fact Most recently-purchased individual life insurance policies are permanent rather than term.

Individual Life Insurance Policies Purchased
by Product Type

Product Type	Percent of Policies
Whole Life	44
Universal Life	14
Variable Life	
Variable Universal Life	1
Total Permanent	60
Term	40
Total	100

less than 1 2 of 1 percent.

Source Second uarter 2010 Individual Life Insurance Sales Survey, LIMRA, 2010.

Permanent Insurance

Permanent insurance offers several unique features not available on most term policies

Access to cash values Permanent insurance builds up cash values that can be used toward a child s education, business opportunities, or to supplement retirement income.

Loans Policyowners can borrow from the cash value at favorable rates, without restrictions such as credit chec s, and without a lengthy application process.

Flexibility If a policyowner needs to stop paying premiums, the policy s cash value can sustain the insurance protection for a period of time.

Guaranteed coverage As long as the required premiums are paid, coverage is guaranteed to last a lifetime. Owners of permanent life insurance policies have the peace of mind of continual coverage, regardless of their health.

Stable premiums Many types of permanent insurance offer level premiums for life, unli e some term premiums that increase substantially as the policyowner ages.

Tax advantages The cash values in permanent life insurance policies accumulate on a tax-deferred basis, similar to retirement and college savings plans.

Source What you need to now about life insurance, the Life and Health Insurance Foundation for Education, 2009.

Permanent Life Insurance Benefits All Incomes

It is a prevailing myth that affluent consumers are the primary purchasers of permanent insurance. The truth is that consumers of all income levels purchase permanent insurance policies with the middle class buying most of them.

Fact Permanent life insurance benefits Americans of all income levels. The affluent (defined as those with household income of 100,000 or more), who represent about 19 percent of the population, own ust 27 percent of existing policies, while those earning 25,000 to 99,999 comprise 55 percent of the population, but own 58 percent of existing policies.

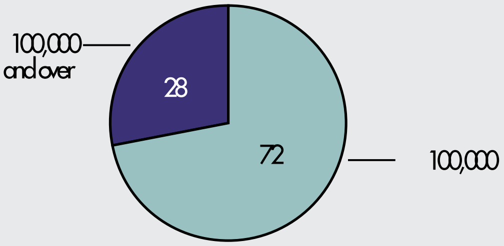
Mar et Share of Permanent Life Insurance Policies Owned
by Annual Household Income

Mar et	Income	Percent of policies	Percent of population
Lower	Less than 10,000	3.9	6.7
	10,000 – 24,999	11.2	19.8
Middle	25,000 – 49,999	23.1	27.3
	50,000 – 74,999	19.5	17.3
	75,000 – 99,999	15.0	10.4
Affluent	100,000 – 199,999	18.0	13.4
	200,000 or more	9.3	5.1
		100.0	100.0

Source LIMRA analysis of 2007 Survey of Consumer Finances, Federal Reserve Board, 2009.

Fact Consumers in the middle class or lower own nearly three quarters of newly purchased permanent life insurance policies.

Mar et Share of New Permanent Life Insurance Policies
By Household Income



Source Finding New Customers Who Is Buying Life and Why LIMRA, 2005.

Why Life Insurance Is Bought and How It Is Used

People buy life insurance for many reasons most often to replace income and pay for the insured's final expenses. Life insurance owners see their policy as the main way to provide for their loved ones in case of untimely death.

Fact Affluent and non-affluent households alike are most li ely to purchase life insurance for income replacement and to cover burial and final expenses.

Reasons for Owning Life Insurance Percent Mentioning, Multiple Responses Possible	
Reasons for Purchase	
Final expenses	78
Income replacement	53
Pay off mortgage	32
Transfer wealth	20
Pay estate taxes or estate bills	19
College funding	10
Tax savings	6
Business purposes	1
Charitable gift	1

Source 2010 U.S. Life Ownership Study, LIMRA.

Fact Almost six in ten U.S. households with dependents plan to use life insurance to provide for their families in the event of their premature death more than any other financial resource.

Sources of Income if Die Prematurely	
Sources of Income	
Life insurance proceeds	57
Savings and investments	52
Social Security	46
Pensions and retirement savings	41
Earnings by other household members	30
Financial help from friends relatives	19
Annuity	11

Source 2010 U.S. Life Ownership Study, LIMRA.

Borrowing from Life Insurance Cash Values

Permanent life insurance builds up cash value that becomes part of the death benefit. In difficult times, policyholders can use the cash value to cover insurance costs or as a source of funds by borrowing or withdrawing the money.

Fact Life insurance cash values serve as a source of available capital to individuals, especially when credit is difficult to obtain. There was $120 billion in life insurance loans outstanding at the end of 2009.

Source LIMRA analysis of SNL Financial LLC data.

Famous retailer .C. Penney borrowed from his life insurance policies to help meet the company payroll following the 1929 stoc mar et crash.

Source www.nndb.com people 656 000160176

In 1953, Walt Disney borrowed from his life insurance, sold his vacation home, and borrowed money from employees to fund Disneyland, his first theme park.

Source www. ustdisney.com walt disney timeline

Policy Loan Basics

- Owners of permanent life insurance may be able to borrow up to between 75 and 90 percent of their cash value.
- Policy loans can be a source of funds for individuals regardless of their credit.
- No lengthy application is required to obtain funds.
- The loan is not taxable as long as the policy remains in force.
- Interest rates are often attractive compared to unsecured loan rates available from financial institutions.

The Growing Need for Retirement Savings and Income

Fewer wor ers are covered by traditional pension plans, and Social Security is pro ected to replace less of a wor er s pre-retirement income in the future than it does today. Therefore, retirees will need products that can create a base of lifetime income, or supplement their existing lifetime income sources. Annuities are an excellent solution to both of these dilemmas, through tax-deferred retirement savings and tax-advantaged lifetime income payments.

Percent of Wor ers with Access to and Participating in Retirement Benefits

	Defined Benefit		Defined Contribution		All Retirement Benefits	
	Access	Participation	Access	Participation	Access	Participation
All wor ers	21	20	61	43	67	51
Employer si e						
1–99 wor ers	10	9	49	32	53	36
100 wor ers	34	32	74	55	83	68

Source National Compensation Survey, Bureau of Labor Statistics, September, 2009. Based on wor ers in private industry.

More than half of pre-retirees and retirees do not expect to receive enough income from Social Security and employer pensions to cover their basic living expenses in retirement.

Fact In 2009 Social Security replaced approximately 40 percent of the average earner s income at retirement and is forecast to fall to 28 percent by 2037.

Sources The Social Security Fix-It Boo , Center for Retirement Research at Boston College, 2009.

Fact Nearly 3 in 5 new middle-class retirees can expect to outlive their financial assets if they try to maintain their pre-retirement living standard.

Source Retirement Vulnerability of New Retirees The Li elihood of Outliving Their Assets, by Ernst oung, for Americans for Secure Retirement, uly 2008.

Fact More than half (56 percent) of pre-retirees and retirees do not expect to receive enough income from Social Security and employer pensions to cover their basic living expenses in retirement. Further, nearly half (44 percent) of these individuals express interest in converting a portion of their savings into guaranteed lifetime income (i.e., annuiti ing), in order to fill the gap between their retirement income and expenses.

Source Retirement Income Preferences, LIMRA, 2006. Based on individuals aged 55 to 70 with at least 50,000 in household investable assets.

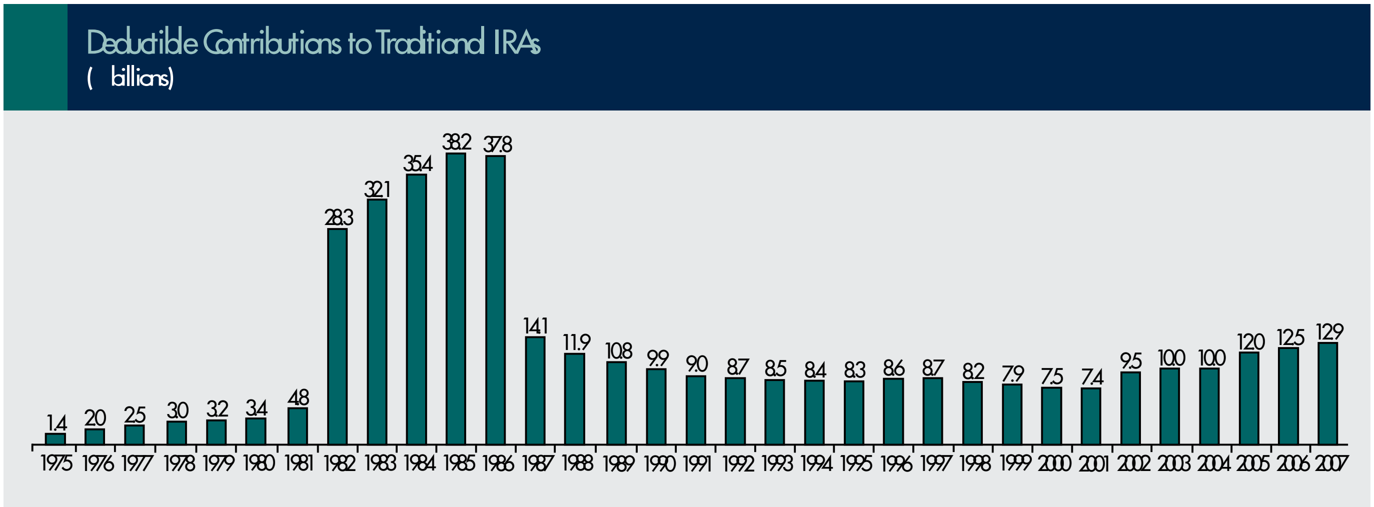
Tax Incentives Encourage Saving

Given these facts, it s clear that more people need to save for retirement and many of those already saving need to save more. Incentives, in the form of tax advantages, are an effective way to encourage saving. While programs such as 401( ) plans and IRAs offer tax-deferred savings, annuities offer additional benefits that are often not available elsewhere. For example, many of today's variable annuities offer the protection of account values or income streams against unfavorable investment returns. Sometimes dismissed as unnecessary, their value becomes clear during these difficult economic times, especially for the millions of Americans approaching retirement.

Fact Nine in ten nonqualified annuity owners agree that keeping the current tax treatment of annuities is a good way to encourage long-term savings (88 percent), and that annuities are an effective way to save for retirement (90 percent).

Source: 2009 Survey of Owners of Non-Qualified Annuity Contracts, conducted by The Gallup Organization and Mathew Greenwald Associates for The Committee of Annuity Insurers, 2009.

Fact Deductible contributions to IRAs surged when universal access to tax-deductible IRAs was granted, only to plummet when later eliminated.



Source Sabelhaus, ohn and Schrass, Daniel, The Evolving Role of IRAs in U.S. Retirement Planning, Research Perspectives, Vol. 15, No. 3, Investment Company Institute, November 2009.

Annuities as a Source of Retirement Security

Other than pensions, annuities are the only products that create a guaranteed lifetime income. Owners of deferred annuities may elect to annuiti e, ta e systematic with-drawals, or ta e withdrawals as needed. Individuals can also purchase immediate annuities using assets from deferred annuities or from other investments. Owners of annuitized nonqualified annuities and nonqualified immediate annuities receive tax benefits into retirement, whereby a part of each income payment is deemed return of principal until the entire principal, or basis, has been excluded.

Many variable deferred annuities offer guarantees in the event that the underlying investments perform worse than expected. Guaranteed minimum income benefits provide guarantees on the amount that can later be annuiti ed. Guaranteed lifetime withdrawal benefits guarantee that a specific amount can be withdrawn each year for life, while offering the possibility for growing income, and access to the account value.

Fact Nearly nine in ten new deferred variable annuities are sold with some type of guaranteed living benefit (when available), such as those described above.

Source: Variable Annuity Guaranteed Living Benefit Election Tracking Survey — Second Quarter 2010, LIMRA.

Fact Three in four (76 percent) nonqualified annuity owners intend to use their annuity for retirement income. Similar numbers of owners say they

- Will use their annuity savings as a financial cushion in case they or their spouse live beyond their life expectancy (83 percent).
- Will use their annuity savings to avoid being a financial burden on their children (81 percent).
- Purchased an annuity to cover the potential expense of unpredictable events such as a catastrophic illness or nursing home care (73 percent).

Source: 2009 Survey of Owners of Non-Qualified Annuity Contracts, conducted by The Gallup Organi ation and Mathew Greenwald Associates for The Committee of Annuity Insurers, 2009.

Fact Annuities are an important income source to many retirees. One in five (19 percent) retirees receive income from individually purchased annuities. Of these retirees, 37 percent receive regular monthly payments guaranteed for life.

Source Will Retirement Assets Last a Lifetime LIMRA, the Society of Actuaries, and the International Foundation for Retirement Education, 2009. Survey based on retirees age 55 to 75 with at least 100,000 in household investable assets.

Fact Over nine in ten nonqualified annuity owners (91 percent) try not to withdraw any money from their annuities before they retire because they would have to pay tax on that money.

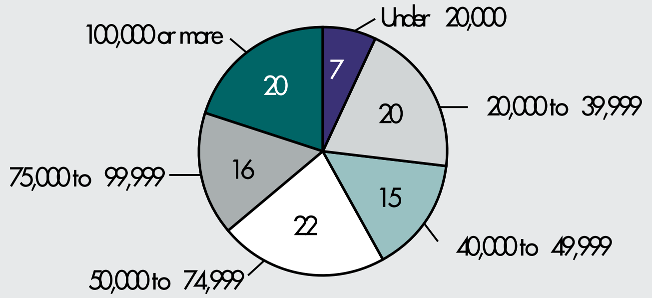
Source: 2009 Survey of Owners of Non-Qualified Annuity Contracts, conducted by The Gallup Organi ation and Mathew Greenwald Associates for The Committee of Annuity Insurers, 2009.

Nonqualified Annuities Benefit All Incomes

Unlike IRAs, nonqualified annuities do not limit contributions or who qualifies to make non-rollover contributions. However, it does not follow that people above the IRA limits are buying annuities in droves. Instead, people of all income levels purchase annuities. Similar to permanent life insurance, the distribution of annuity owners by income does not depart significantly from the distribution of incomes generally.

Fact Four in five nonqualified annuity owners are middle class or below.

Mar et Share of Nonqualified Annuities Owned
by Annual Household Income



Source: 2009 Survey of Owners of Non-Qualified Annuity Contracts, conducted by The Gallup Organi ation and Mathew Greenwald Associates for The Committee of Annuity Insurers, 2009.

Four in five nonqualified annuity owners are middle class or below.

Nearly nine in ten new deferred variable annuities *are sold with some type of guaranteed living benefit* (when available).

Types of Deferred Annuities

Deferred annuities are investment vehicles that offer tax-advantaged savings and the ability to receive income payments guaranteed for life. There are three main types of annuities that determine how values accumulate and how income payments are determined.

The values in variable annuities change based on the performance of the underlying subaccounts selected by the investor. The subaccounts are typically invested in stoc s, bonds, and or money mar et portfolios. As described earlier, some variable annuities provide guarantees of the account value.

Fixed rate annuities offer a predetermined interest rate for a set period of time.

Indexed annuities are fixed annuities that offer a guaranteed minimum rate of return with the ability to participate in performance lin ed to one or more equity indices.

The Value of Tax-Deferral

As far bac as the enactment of the modern income tax, policyma ers have ac nowledged the value that life insurance and annuities provide by allowing policy values to accumulate on a tax-deferred basis. The U.S. Government includes in its annual budget a long list of “tax expenditures,” defined as “revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of liability. The government often loo s to this list for opportunities to raise tax revenues. The deferral of income on life insurance and annuity contracts is Number 14 on the list. The budget estimates this tax expenditure at 23.1 billion in 2011, growing to 29.9 billion in 2015, an annual effective growth of 6.7 percent.[1]

Recent federal tax legislation continues to support retirement savings and retirement security. The Pension Protection Act of 2006 strengthened traditional pension plan funding, offered new and enhanced retirement savings incentives to IRAs and defined contribution plans, tax benefits for combination products that combine life or annuity products with long-term care coverage, and provided permanency to many provisions of the 2001 Economic Growth and Tax Relief Reconciliation Act that were due to expire on anuary 1, 2011.

[1] Source: Executive Office of the President, Office of Management and Budget, *Analytical Perspectives, Budget of the United States Government, Fiscal ear 2011.*

Life Insurance

There are now many different types of permanent life insurance available in the marketplace, making it very difficult to develop an industry-level model of life insurance cash value. However, life insurance cash values (because of their nature) generally don t increase as rapidly as annuity cash values. In the case of annuities, the cash value is the primary benefit of the policy. In the case of life insurance, the cash value is a mechanism that allows the policy to provide various benefits to policyholders. Permanent life insurance is often structured so that premium requirements decrease as cash value grows. In addition, policyholders have the option to ta e loans from their cash value to meet immediate financial needs without having to lapse their life insurance protection.

If the government removes the tax-deferred nature of the cash value build up, the safety net that permanent life insurance provides for so many middle and lower income households would be at ris . Reasons for this include

- While level-premium permanent life insurance may continue to be available, the total cost of that coverage including taxes will generally increase over time, impeding affordability as policyowners age.
- Policyholders that are in paid-up status due to the application of dividend payments and or cash value buildup might be forced out of paid-up status by the need to ma e withdrawals from the life insurance policy in order to pay taxes. And, policyholders who ma e regular premium payments might well need to either reduce premium payments to pay taxes or begin ma ing partial withdrawals from their policy in order to pay taxes. In either case, the policy could eventually be in eopardy due to cash value depletion, and tax revenues would decline due to the smaller base of cash values to tax.
- Because of the many moving parts of life insurance, such as premium payments, expense charges, and mortality charges, it would be difficult to determine the taxable portion of any increases in life insurance cash values. Further, explaining the result to policyholders in a manner they could understand would be challenging.

Life insurers have 4.5 trillion invested in the U.S. economy, ma ing them one of the largest sources of capital in the nation.

Annuities

With the impending Social Security crisis, retirees and pre-retirees will need to take greater responsibility for their financial security in retirement. The guarantees available (and often purchased) in today s annuity products help to provide that financial security. Taxing account value growth each year would in many cases make it more difficult for annuity buyers to fund these guarantees. Annuity owners without other resources to pay the taxes would need to ma e withdrawals from their annuities to pay them. This would have several unintended consequences, including

- A reduction in pro ected future tax revenues because account values would grow at a slower rate due to withdrawals to pay taxes.
- Owners of annuities with guarantee features could render some guarantee features worthless due to excessive withdrawals to pay taxes.
- Insurers would be forced to raise fees on these features or stop offering them altogether. Increased fees would ma e these features less attractive to potential buyers, which in turn would lead to reduced future sales and, therefore, reduced tax revenues.

LIMRA developed a model to estimate the tax impact of a removal of the tax deferral feature on nonqualified annuities.[2]

- Under a best case scenario, estimated tax revenues would grow an average of 5.6 percent per year between 2011 and 2015, slightly less than the government s pro ected rate of 6.7 percent.[3]
- Under a more realistic scenario, estimated tax revenues would actually decline 24 percent during the period 2011 to 2015, by which point annual tax revenues would be 41 percent lower than those based on the government s growth rate.[4]

[2] Our model assumes that all annuity contracts experience investment gains in their cash values each year. This assumption would tend to overestimate tax revenues since some annuities will lose value in years such as 2008, most variable annuities would lose value. We did not net out taxes that are due regardless of any change to annuity taxation, such as taxes due upon withdrawal or contract surrender. The model also assumes gains in value are taxed as ordinary income, which would be less preferential than on other investments, which are taxed as capital gains. Currently, the maximum long-term capital gains tax rate is 20 . Because we assume an average marginal income tax rate of approximately 28 percent to be applied to annuity gains, our estimated tax revenues using capital gains taxes would fall by more than 25 compared to using ordinary income taxes. Further, taxing annuity growth annually as ordinary income further puts annuities at a disadvantage to mutual funds, whose basis is stepped up upon the owner s death.

[3] The best case scenario assumes any change in the tax treatment of account value growth does not impact the future rate of sales, surrender, growth, and other flows of funds.

[4] The more realistic scenario assumes a one-time decline in sales of 25 and the rate of surrender more than doubling to 25 in 2012. Thereafter, sales are assumed to decrease by 5 percent each year and the surrender rate is assumed to decline over three years before leveling off at 12 .

Life Insurance Industry Benefits to Society

Beyond the obvious benefits of insuring people, and making payments to beneficiaries, the insurance industry is a ma or employer, investor, lender, charitable donor, and taxpayer.

Fact Life insurers infused nearly 59 billion into the U.S. economy in 2009 through death benefits paid to beneficiaries.
Source LIMRA analysis of SNL Financial LLC data.

Fact Life insurers infused 65 billion of annuity benefits into the U.S. economy in 2009.
Source LIMRA analysis of SNL Financial LLC data.

Fact The life insurance industry employs about 1.2 million people nationwide. The entire insurance industry employs 2.2 million people in the United States.
Source ACLI

Fact Life insurers provide a significant source of funding to consumers and businesses. As of the end of 2009, life insurers held 325 billion in commercial and residential property loans.
Source LIMRA analysis of SNL Financial LLC data.

Fact Life insurers have 4.5 trillion invested in the U.S. economy, ma ing them one of the largest sources of capital in the nation.
Source ACLI

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