

The Facts of Life *and Annuities*







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The Facts of Life *and* Annuities

Since the financial crisis at the end of 2008, our world has changed remarkably. We now live in a time of government financial bailouts and trillion dollar stimulus programs. Trust and confidence in the financial system has been severely shaken.

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 work to children or a charity. In addition, many of the 77 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.

This booklet describes the value that life insurance company products provide.

7 Key Facts

1. Life insurers paid out more than \$56 billion in death benefits and \$70 billion in annuity benefits in 2007.
2. Nearly four in five U.S. households own life insurance.
3. The average person owns less life insurance (3.6 times income) than they believe they should own (5.7 times income).
4. Following the September 11 attacks, the Victim Compensation Fund valued the future earning potential of victims at nearly 16 times income.
5. Owners of life insurance say they purchase insurance to cover burial and final expenses, as well as for income replacement.
6. 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.
7. One in five retirees uses individually purchased annuities for income.





Life Insurance Ownership Is Widespread, but Inadequate

Nearly 80 percent of U.S. households have some form of life insurance coverage, yet they also admit they need more.

Fact: Nearly four in five U.S. households own some type of life insurance. Half of U.S. households own individual life insurance.

Source: *Trends in Life Insurance Ownership Among U.S. Households*, LIMRA, 2005.

Fact: The average U.S. household with life insurance owns enough to replace 3.6 years of income. This measure is consistent across all income groups.

Source: *Trends in Life Insurance Ownership Among U.S. Households*, LIMRA, 2005.

Fact: Forty-eight million U.S. households (44 percent) believe they do not have enough life insurance.

Perceived Gap in Life Insurance Coverage

In years of income

Average coverage the household believes it should have	5.7 years
Current coverage	3.6
Gap (should have — coverage)	<u>2.1</u>

Source: *Trends in Life Insurance Ownership Among U.S. Households*, LIMRA, 2005.

The Victim Compensation Fund paid out \$6 billion to nearly 3,000 families of those killed in the September 11 attacks 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 Justice, and LIMRA analysis.



The U.S. Armed Forces increased the life insurance it makes available to soldiers who die in combat or in combat-related situations. On September 1, 2005, the maximum Servicemembers' 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 Servicemembers*, American Forces Press Service, July 7, 2005.

Most Individual Life Insurance Policies Are Permanent

There are two primary types of life insurance: term insurance and permanent insurance. As its name implies, term insurance provides protection for a specified period of time. Permanent insurance provides lifetime protection and allows for a cash value to accumulate on a tax-deferred basis.

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.

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 checks, 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, unlike 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 Know About Life Insurance*, the Life and Health Insurance Foundation for Education, 2006.

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 is also used to pay off the mortgage, transfer wealth, replace another policy, for college funding, tax savings, to pay estate taxes, for business purposes, and charitable gifting. Life insurance owners see their policy as the main way to provide for their loved ones in case of untimely death.



Fact: Half of individual life insurance owners 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 Someone Died Prematurely

Sources of Income

Life insurance proceeds	51%
Savings and investments	41
Social Security	38
Pensions and retirement savings	35
Earnings by other household members	26
Annuity	10

Source: 2005 LIMRA Life Insurance Ownership Study.

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 \$116 billion in life insurance loans outstanding at the end of 2007.

Source: LIMRA analysis of A.M. Best annual statement data.

Famous retailer **J.C. Penney** borrowed from his life insurance policies to help meet the company payroll following the 1929 stock market 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.justdisney.com/walt_disney/timeline

- 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 workers are covered by traditional pension plans, and Social Security is projected to replace less of a worker'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.



Fact: Social Security replaces approximately 41 percent of the average earner's income at retirement and is forecast to fall to 30.5 percent. A 10 percent benefit cut would further reduce this replacement rate to 26.9 percent.

Sources: Alicia H. Munnell, "The Declining Role of Social Security" *Just the Facts on Retirement Issues*, No. 6, Center for Retirement Research at Boston College, February 2003.

"Social Security, Medicare and Americans' Confidence in Their Retirement Future" *Watson Wyatt Insider*, September 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 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.

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 convert their balance to a guaranteed lifetime income, take automatic withdrawals, or take withdrawals as needed. Individuals can also purchase income annuities using assets from deferred annuities or from other investments. Owners of annuities and nonqualified income annuities receive tax benefits into retirement.

Fact: Four in five (78 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 (70 percent).

Source: 2005 Survey of Owners of Non-Qualified Annuity Contracts, conducted by The Gallup Organization and Mathew Greenwald & Associates for The Committee of Annuity Insurers, 2005.

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.

Types of 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 stocks, bonds, and/or money market 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 linked to one or more equity indices.
- *Income annuities* are either deferred annuities where the owner has elected to receive regular income payments (usually lifetime payments), or immediate annuities purchased to create regular income that begins within 13 months of purchase.
- *Nonqualified annuities* are annuities purchased with funds that are not part of any qualified retirement program (such as a 401(k) or IRA).

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.



Life Insurance Industry Benefits to Society

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

Fact: Life insurers infused more than \$56 billion into the U.S. economy in 2007 through death benefits paid to beneficiaries.

Source: LIMRA analysis of A.M. Best annual statement data.

Fact: Life insurers infused more than \$70 billion of annuity benefits into the U.S. economy in 2007.

Source: LIMRA analysis of A.M. Best annual statement 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 2007, life insurers held \$324 billion in commercial and residential property loans.

Source: LIMRA analysis of A.M. Best annual statement data.

Fact: Life insurers have \$4.3 trillion invested in the U.S. economy, making them one of the largest sources of capital in the nation.

Source: ACLI

Fact: Life insurers paid more than \$19 billion in federal, state, and local government taxes in 2007. This figure does not include taxes paid by the people the industry employs or businesses that supply the industry with related services.

Source: LIMRA analysis of A.M. Best annual statement data.



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