

September  
2011 Update

# The Facts of Life *and Annuities*



**LIMRA**<sup>®</sup>



# The Facts of Life *and Annuities*

Introduction.....	2
Key Facts.....	2
Life Insurance Ownership Is Widespread, But Inadequate.....	3-4
Most Individual Life Insurance Policies Are Permanent.....	5
Permanent Life Insurance Benefits All Incomes...	6
Why Life Insurance Is Bought and How It Is Used.....	7
Borrowing from Life Insurance Cash Values.....	8
The Growing Need for Retirement Savings and Income.....	9
Tax Incentives Encourage Saving.....	9
Annuities as a Source of Retirement Security...	10
Nonqualified Annuities Benefit All Incomes.....	11
The Value of Tax-Deferral.....	12-14
Life Insurance Industry Benefits to Society.....	14

LIMRA conducts research on behalf of our members in the insurance and financial services industry. While LIMRA does not advocate or take positions on legislative or regulatory issues, we use research to help our members and the industry educate and inform the public on such issues. This publication was developed to serve that purpose.

For more information, please contact Eric T. Sondergeld at [esondergeld@limra.com](mailto:esondergeld@limra.com) or (860) 298-3957.

Among financial experts, there is intense debate over our global economic outlook. While market fluctuations are normal, the recent financial crisis has brought additional volatility. There is uncertainty among consumers, who are finding financial decision making that much more complex.

Today, individual life insurance ownership is at a 50 year low, but when asked, half of U.S. households say they do not have enough life insurance – the highest proportion ever. Americans are unprepared for retirement, and recent equity markets are only making the problem worse.

To begin to address this, trust and confidence in our financial system must be restored. 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 work 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. Policymakers — since the earliest days of the modern income tax — have recognized the value that life and annuity products provide, and acknowledge 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.

## 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 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



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	Years 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.

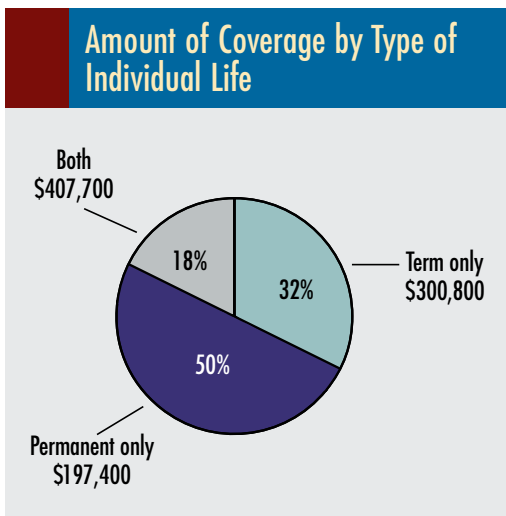
Source: 2010 U.S. *Life Ownership Study*, LIMRA.

**Fact:** Households that feel they don't have enough life insurance say most consumers should own enough life insurance to replace 6.8 years of income, yet only have enough to replace their own income for 2.6 years.

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.



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

**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

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 Quarter 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 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, 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 just 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.



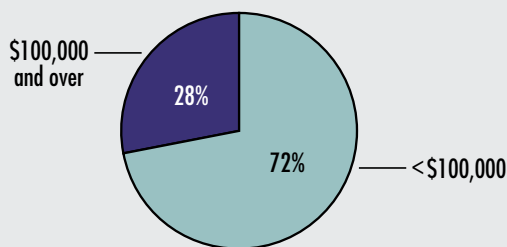
## Market Share of Permanent Life Insurance Policies Owned by Annual Household Income

Market	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.

## Market 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 likely 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 **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/](http://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](http://www.justdisney.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.
- Like many other types of loans, 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.

## Percent of Workers with Access to and Participating in Retirement Benefits

	Defined Benefit		Defined Contribution		All Retirement Benefits	
	Access	Participation	Access	Participation	Access	Participation
All workers	21%	20%	61%	43%	67%	51%
Employer size						
1-99 workers	10	9	49	32	53	36
100+ workers	34	32	74	55	83	68

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

**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 Book, 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 Likelihood of Outliving Their Assets*, by Ernst & Young, for Americans for Secure Retirement, July 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., annuitizing), 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(k) 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.

*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.*

# 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 annuitize, take systematic with-drawals, or take 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 annuitized. 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 Organization 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.

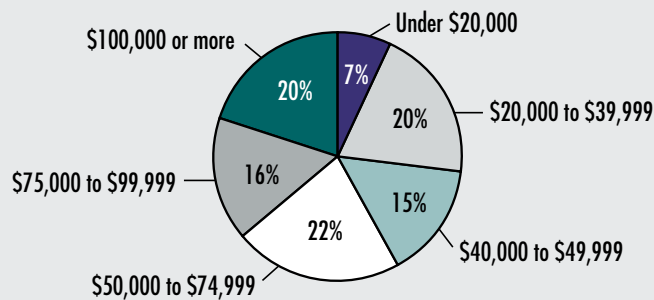
Source: 2009 Survey of Owners of Non-Qualified Annuity Contracts, conducted by The Gallup Organization and Mathew Greenwald & Associates for The Committee of Annuity Insurers, 2009.

# Nonqualified Annuities Benefit All Incomes

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.

**Market Share of Nonqualified Annuities Owned**  
by Annual Household Income



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.

*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 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.

# The Value of Tax-Deferral

As far back as the enactment of the modern income tax, policymakers have acknowledged 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 looks to this list for opportunities to raise tax revenues. The deferral of income on life insurance and annuity contracts is Number 15 on the list. The budget estimates this tax expenditure at \$22.7 billion in 2012, growing to \$28.9 billion in 2015, an annual effective growth of 6.3 percent.<sup>1</sup>

**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 January 1, 2011.



<sup>1</sup> Source: Executive Office of the President, Office of Management and Budget, *Analytical Perspectives, Budget of the United States Government, Fiscal Year 2012*.

## The Value of Tax-Deferral (Continued)



### 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 take 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 risk. 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 make withdrawals from the life insurance policy in order to pay taxes. And, policyholders who make regular premium payments might well need to either reduce premium payments to pay taxes or begin making partial withdrawals from their policy in order to pay taxes. In either case, the policy could eventually be in jeopardy 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, making them one of the largest sources of capital in the nation.*

“Permanent forms of life insurance often are described as financial protection coupled with a tax-deferred savings component (cash value). It is important to keep in mind that an individual is subject to taxes on the earnings in their cash value if the policy is surrendered before the death of the insured.”



## 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 make withdrawals from their annuities to pay them. This could have several unintended consequences, including:

- A reduction in projected 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 worth less 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 make these features less attractive to potential buyers, which in turn would lead to reduced future sales and, therefore, reduced tax revenues.

## 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 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 generates approximately 2.5 million jobs in the U.S., including direct employees, those who sell life insurance products, and non-insurance jobs supported by the industry.

Source: ACLI calculations based on 2009 BLS Employment Data.

**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, making them one of the largest sources of capital in the nation.

Source: ACLI

LL Global, Inc.



[www.limra.com](http://www.limra.com)



[www.loma.org](http://www.loma.org)

**HARTFORD   ATLANTA   MIAMI   TORONTO   LONDON   KUALA LUMPUR   SHANGHAI   HO CHI MINH CITY   SEOUL**

©2011, LL Global, Inc.<sup>SM</sup>

This publication is a benefit of LIMRA membership.

No part may be shared with other organizations or reproduced in any form without LL Global's written permission.