



P.O. BOX 151  
350 MILLBURN AVENUE  
MILLBURN  
NEW JERSEY 07041  
973-379-7666  
973-379-7277 FAX

# VALUE BUILDING

*From Paul A. Gomperz, CLU, ChFC*

INVESTMENT OUTLOOK

April 2007

## ***The Have Your Cake and Eat It Strategy***

One of the financial planning subjects that is making a lot of headlines deals with the tools and strategies that the Baby Boomers, now turning Age 61, need to consider if their retirement years are to be free of any concerns as to the longevity of their retirement income. We continue to see examples of people who may have a longer life span during their retirement than the sum of their working years. It is one thing to accumulate money but a totally different thing to make it last as long as you do. This threat to our financial well being is best seen in our world by the formats that life insurance companies use in their illustrations. On the most part, as computer generated illustrations came into vogue in the 1980's, these tabular charts ran to Age 95 or 100. Who ever heard of a person living beyond Age 100? But with new mortality data in the bank, and the speed with which medical science is lengthening our life expectancy, the typical life insurance illustration now runs out to Age 115 at a minimum! Policies that used to mature at Age 95 or 100 are being amended to include a Deferred Maturity Option allowing the tax free payment of the death benefit to be pushed out beyond the policy's original expiration date. Remember that money received from a maturing policy during your lifetime is subject to ordinary income tax on any gain. That could be a disaster.

Let us get back to the subject of your retirement income lasting for your lifetime. The January/February 2007 issue of the Financial Analysts Journal carried an article titled "A Mutual Fund to Yield Annuity-Like Benefits." The author recalled that in the old days when people worked for companies that gave their employees a Pension Plan. In a nutshell, the company not only provided you with salary and benefits during your working years, but following your retirement, their Pension Plan would guarantee you an income for as long as you lived. The better plans even provided a cost of living escalation to account for the effect of inflation. The risk of having sufficient funds to pay these benefits was totally that of the employer. In 1974, congress passed ERISA that formalized the rules and created the Pension Benefit Guarantee Corporation so that if a company failed, the PBGC would pay its liabilities.

The volatility of the stock market, however, as well as some large plan failures caused the cost of the premiums on this insurance to become so high, that companies began eliminating the guaranteed pension plans in favor of Money Accumulation plans. In these plans, the employer would continue to make a deposit but the amount of retirement income provided by the plan was subject to investment results. Frequently, the investment strategy on what to do with the money was left to the employees and additional investments by the employee were allowed under the rules of Section 401(k) or Section 403(b) for non-profit entities. Employees whose skill set might not include the formulation of investment strategies were now left with the challenge of deciding how to invest their funds to assure that income would last for a lifetime. But with that, came a secondary concern that the principal remain intact so that it could be passed on to the kids. When our parents retired, their pensions ran for their lifetimes to include both husband and wife, but there never was any money left for the kids. If leaving the money for the kids now becomes a requirement, that has to reduce the amount of income a retired person can draw.

The vehicle that provided guaranteed income for life, but no residual capital, was always a life annuity issued by an insurance company. It was alright for companies to purchase these annuities to fund their pension plan benefits, but individuals tend to avoid them because the capital or principal is exchanged for the guaranteed income stream. But now comes a new concept offered by several life insurance companies which, in deference to the various product names, I shall label as "The Have Your Cake and Eat It Strategy." The concept is very simple and works like this.

The plan offers a guaranteed accumulation period followed by a guaranteed income period. Let's first look at the accumulation phase. You invest your money into the plan and you are immediately given a guarantee that your principal will increase by 5% or 6% (depending upon the insurance company) simple interest each year. As such, a \$500,000 investment is guaranteed to grow by \$25,000 per year at a minimum. After ten years, the minimum investment value would be \$750,000. At the same time, the insurance company offers you equity portfolios they manage and which are labeled anywhere from Conservative to Aggressive. We feel that given the underlying "no loss guarantee," one should select the most aggressive portfolio available. These portfolios have histories that run between 8% and 10% per year. Let's use a specific example. A 57-year-old person invests \$500,000 and makes no withdrawals for eight years. At 9% compounded growth, the account doubles and the \$500,000 is now worth \$1 million. But underlying that growth, is the guarantee that the \$500,000 will grow by \$25,000 (using 5%) each year so that after nine years, the client cannot be worth less than \$725,000. Basically, the risk of growing your money has been eliminated and you have a reasonable chance of doubling your money before withdrawals begin.

Let's turn to the Lifetime Income or Distribution phase. When you begin drawing income, the guaranteed annual increases in value stop. They are replaced by a guaranteed annual income that can grow. Assuming that your account is now worth \$1 million, you are guaranteed 5% per year in income on the year end anniversary high water mark. Let's run some numbers. The first year, you draw a \$50,000 income. Let's assume your account earned 8% that year so, at year-end, you are worth \$1,030,000. That means that 5% of the high water mark will pay you \$51,500 in the second year and that becomes your new minimum income for life. Let's assume that in the second year, the account earns 9% which takes your value to \$1,071,200 and creates a third year income to you of \$53,560 which now becomes your new minimum income for life. Let us also assume that in the third year the investment value goes down. You will continue to receive \$53,560 per year until the investment regains sufficient value to again pay you increases, which then become the guaranteed high water mark income level. If the investment value were to go down to nothing, the income is still guaranteed for your life. If you are willing to give up 1/10th of 1% of your investment yield, that income can be guaranteed to last so long as you or your spouse lives. When both of you have passed on, the remaining balance goes to your beneficiaries.

There is liquidity in these accounts. During the first seven years, you can withdraw up to 10% of your investment with no penalty. There is no penalty after seven years. You can shorten the penalty period for a slight charge against earnings. If you withdraw a lump sum amount after you begin drawing income, then both the income and its guarantee are reduced by the percentage that the withdrawal represented of the total account.

The bottom line is that you have guaranteed growth during the accumulation and guaranteed life income during the distribution phase along with the probability that there will be a residual amount of principal paid to your heirs. Wouldn't you agree that this is a "Have Your Cake and Eat It" strategy?

### ***Do Not Discard Your Unwanted Life Insurance Policies... You Have Options!***

For generations, people have purchased life insurance for a variety of personal and business reasons. When the reasons no longer existed, the policy would be lapsed or surrendered. Today, that policy can be sold. No longer must you absorb the cost of a term insurance policy you no longer need or give up the policy for the cash surrender value the insurance company says it is worth. The value of that policy is established on the open market and is whatever an investor will pay you for it. Investors are generally interested in policies where their money is tied up for 10 or 15 years and some will go out to 20 years. That means this option is usually reserved for people in their 70's or 80's.

Consider the person who purchased a policy that would pay off their mortgage, cover their children's' education and provide income for their spouse. Today the insured is in their mid 70's or older, the mortgage is paid, the kids are all grown up and educated, they are living on their retirement income, don't need the insurance, but would love to increase their income if they could only get their hands on the cash. There is a "Settlement" option available.

The Settlement buyer will need to know your health so that your life expectancy can be evaluated. They also need to determine the future cost to maintain the policy for a little beyond your expected life span. The policy's death benefit, minus what they would have to pay to sustain it is their profit margin. Based upon the interest rate they want this investment to yield, it establishes a price they will pay.

Confidentiality is the most important aspect of this transaction. We work through a Broker headed by the long-term former President of a major life insurance company we use for many of our clients. They put the package together by gathering health histories and policy projections. They have over 100 "Providers" to whom they send out the package and request bids. The Providers represent the Investors and are the buffer so that Investors never know the names of the persons whose policies they buy. The investors are firms such as Goldman Sachs and Merrill Lynch. They bundle policies and sell portions as an investment that returns a better yield than bonds.

The minimum size policy for this type of transaction is normally \$250,000 but lower amounts might work for older people. For example, some of the offers we have generated for clients include \$125,000 for a 75 year old woman whose \$1 million policy had a cash value of \$85,000 and would have cost over \$20,000 per year to keep, and a \$200,000 offer for a \$400,000 policy on an 85 year old male that would have cost over \$20,000 per year to keep.

Let us know if you or someone you know would like to discuss any of these strategies and opportunities.

**Paul A. Gomperz, CLU, ChFC**  
**1 – 888 - PLAN AHEAD**  
**[pgomperz@vbscorp.com](mailto:pgomperz@vbscorp.com)**  
**Visit our website at [www.vbscorp.com](http://www.vbscorp.com)**