



Longevity Insurance: Financial Product for the Ages

By Andrew L. Gespass

There has been a lot of buzz lately about a new financial product dubbed "longevity insurance." In its current form, longevity insurance is a deep-deferred annuity with a forfeiture provision. A typical example might be as follows: Mr. Smith, age 60, pays Old Grand-Dad Insurance Co. a single premium of \$50,000. In return, Old Grand-Dad promises to pay Mr. Smith \$4,000 a month for life beginning at age 85. If Mr. Smith fails to make it to age 85, the investment is lost. If he makes it to 100, Old Grand-Dad will have paid Mr. Smith \$720,000. That's the concept in its purest form. Variations include a refund-of-premium feature and an option for increasing annuity payments, both of which add to the initial cost.

The continued popularity of contribution plans and IRAs has allowed many investors to accumulate more retirement assets. But the declining confidence in the Social Security system, as well as the dwindling presence of old-style pensions and defined-benefit retirement plans, leave soon-to-be retirees less certain about their financial future. This, along with the increasing probability of living into advanced old age—a woman age 65 has a 44 percent chance of surviving to age 90 and a 23 percent chance of surviving to age 95—creates some well-founded anxiety among those planning for retirement that they will outlive their assets.

Longevity insurance not only eases this anxiety by providing guaranteed income, it can also provide additional benefits when used as part of a larger financial strategy. From tax savings to risk mitigation, longevity insurance products provide another tool for investment advisors to consider when creating a smart, tax-aware retirement strategy for clients.

Longevity Insurance Strategies

Easing lifetime gifts. Even relatively wealthy clients, when confronted with the basic arithmetic of estate tax planning and the tax benefits of lifetime gifts, express concerns about old-age impoverishment. Pessimistic assumptions about inflation and investment return coupled with optimistic longevity assumptions can lead to the conclusion that lifetime gifts are not affordable. From the beneficiaries' standpoint, the sacrifice of future value, should the longevity bet perform poorly, may be offset by the tax benefits of lifetime gifts. The same reasoning applies to lifetime charitable gifts. One may be encouraged to make lifetime gifts (and capture the income tax benefits) if old-age financial security is enhanced.

Hedging life insurance. If a client has substantially invested in life insurance or has insurance from other sources, longevity insurance may be viewed as a hedge. Many life insurance policies being sold now have lapse prevention guarantees, which keep the death benefit intact even after the policy's cash value has been reduced to zero, as long as the annual premium continues to be paid. The tepid returns on guaranteed death benefit policies for insureds who survive beyond their mid-eighties can be propped up to some extent by securing payment of the premium in the later years.]

Split-dollar loans. Private split-dollar loans between the insured and the insured's grantor trust may enable a client to obtain substantial insurance protection without current gift tax. The split-dollar regulations under Internal Revenue Code Section 7872 offer a kind of safe harbor for such arrangements as long as there is "substantial likelihood of repayment." Policy death benefits may show a positive return for annual loans compounded at the applicable federal rate through the insured's early eighties, but are difficult to sustain thereafter.

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Assignment of a longevity contract to the insurance trust will secure likelihood of repayment in the outer years and reduce the risk that loans will be recharacterized as gifts with retained interests.

Successor trust beneficiary. A successor beneficiary of trust income may want to ensure that the benefit begins at a certain time. The beneficiary may want to hedge against an actuarially unlikely delay. A remainder beneficiary may be similarly motivated.

Private annuities. Although recently issued regulations make planning with private annuities less attractive, they remain useful tools in certain circumstances. The issuer can ensure a certain return by purchasing a longevity contract on the annuitant.

Fiduciaries. Trusts with annuity obligations may benefit from longevity insurance, especially when trust corpus could be exhausted by distributions to other beneficiaries.

Charities. An issuer of charitable gift annuities may want to hedge the risk of unexpected longevity without making a more substantial commitment to a standard life annuity. The presence of the longevity insurance may make donors more comfortable with the charity's gift annuity program.

The purchase of longevity insurance can be viewed as an exchange of current liquidity for future security. Unlike a standard life annuity, however, the potential return is enhanced by the insurance element. The current liquidity sacrifice is limited. The investment vehicle is more narrowly focused on the goal of advanced old-age income security. With some assurance of income at advanced ages, a person planning for retirement may be encouraged to invest more aggressively or maybe to retire sooner.

The longevity insurance market is still in its infancy, and issuers will likely refine the product as it is exposed to the marketplace. In addition, tax uncertainties and drawbacks remain, but there is some legislative activity favorable to longevity insurance (for example, proposals that would attribute zero value to longevity insurance for purposes of retirement account minimum distribution rules until annuity payments actually begin). Popular concern about financial security in extreme old age may motivate positive changes in the taxation and economics of longevity insurance.