Old-Age Adults, Estate Planning, and Distribution Planning

Learning Objectives
An understanding of the material in this chapter should enable you to

8-1. Describe the distinguishing characteristics and needs of the old-age adult segment.
8-2. Explain how seminars can be used as an approach to senior prospects.
8-3. Explain the concepts of property, wills, estate and gift tax, and applicable credit amount as they relate to estate planning.
8-4. Explain the key elements of distribution planning for retirees.

This chapter focuses on the needs, characteristics, and insurance products appropriate to the old-age adult market segment. It also introduces some estate planning topics and discusses distribution planning considerations.

LIFE CYCLE: OLD-AGE ADULTS

This section covers the common characteristics of the old-age adult market segment—those aged 76 and older. As with the other segments in the life cycle, we focus on common characteristics and needs for this group.

Old-Age Market Segment

Old age is really a social category defined differently by various cultures. In the United States, we define old age in a number of ways:

- Age 40 is the age at and beyond which a person may not be discriminated against in employment (Age Discrimination in Employment Act or ADEA).
- Age 55 is the age at which low-income individuals may qualify for subsidized employment and subsidies to learn new work skills (Title V of the Older Americans Act).
• Age 60 is the age of eligibility for Older Americans Act services. Due to limited funding, however, services are targeted to those older people who are most needy (Older Americans Act of 1965).
• Age 62 is the earliest age at which persons can begin receiving Social Security retirement benefits on their own earnings record (The Social Security Act).
• Age 65 has been the traditional retirement age, coinciding with full retirement age for Social Security benefit purposes. However, because of longer life expectancies, full retirement age has increased for people born after 1938. It ranges from 65 to 67 depending upon the year of the recipient’s birth (The Social Security Act).
• Age 70 has been the mandatory retirement age for members of some professions.

Rather than categorizing everyone past a certain age as being old, some social gerontologists make a distinction between the young-old (ages fifty-five to seventy-four) and the old-old (ages seventy-five and older). Still other gerontologists add a middle-old category between the other two categories. However the aged are categorized, aging is a highly individual experience. Chronological age may differ considerably from a person’s functional age, and age-related changes occur at different rates for different persons. Age-related changes do not begin at the same time nor do they all occur simultaneously. The typical beginnings of change in the five senses are as follows:

• hearing in the mid 40s
• vision in the mid 50s
• touch in the mid 50s
• taste in the late 50s
• smell in the mid 70s

Common Characteristics

People are living longer. The number of people reaching the old-age adult segment in life is growing significantly. In 1990, there were 3.6 million people aged 85 and older. As of July 2007, this number had grown to 5.5 million. Sixty-five percent of the over-85 populations are women.

Because of the burgeoning size and heterogeneous nature of our nation’s aging population, today’s advisors need to understand the financial issues of aging. This segment is growing so significantly that a new discipline called financial gerontology has developed, dedicated to understanding the financial needs and related issues of the older population. Topics such as life settlements, Medicare benefits, Medicaid, reverse mortgages, retirement planning, post-retirement planning, annuity regulation, sales conduct issues
regarding senior citizens, long-term care, and estate planning are just a few of the senior planning issues in this field.

Where once it was unusual for families to have three living generations, today it is common for families to have four living generations. Many persons experience full lives for two to four decades past age 60. In fact, many are quite capable of fully enjoying life until the end of their lives. While advisors must be careful about stereotyping the older population, here are some of the common characteristics within this age group.

**Cognitive Changes.** For most, an ability to learn does not decrease with age until very late in life. In fact, some areas of intelligence increase with age. The old adage, “use it or lose it” seems to apply when it comes to the brain. There is a declining ability to acquire new intelligence, but a sustained ability to apply existing knowledge (for example, wisdom is maintained, wit declines). Aging has little effect on the size of working memory, but it does impair the transfer of information from the short-term to long-term storage. For some older persons, advisors may need to present information more slowly or repeat it to reinforce understanding.

On the other hand, many people over age 60 are adept at handling their finances on the computer, surfing the Internet, taking courses, and performing mental activities that challenge even the brightest 21 year old. You see more and more seniors skydiving, rock climbing, and doing other physical activities far from the rocking chair on the porch. Many in this age group are as active as they ever were.

**Physical Changes.** Hearing loss is very common and often one must speak louder or repeat oneself with an older person. The loss of existing knowledge (for example, knowing how to dress oneself) is a pathological change, not a normal consequence of aging. There is a slowing down of motor response, reaction time, and the ability to complete complex tasks. In some tasks, this slower response time may cause older people to spend more time checking results and making sure they are accurate. If given the time and opportunity, they can compensate for slower reactions by shifting emphasis from speed to accuracy. Overall, these age changes have little effect on the capacity of older adults to perform well at home and on the job.

**Psychological Changes.** The elderly have to come to terms with their changing role in life, and individuals respond in different ways. Society causes many older people to assume a dependent role through retirement and pensions. Some elderly people are quite content to accept these changes, while others deny that they are occurring or may even become depressive as a result. Many use the extra time to take up additional activities and interests and have a fulfilling old age.
There are strong emotions and new realities that must be dealt with in the old-age segment of the life cycle. It is a time when relatives, friends, and spouses die. Consequently, there is an increased awareness of death as the final reality. There is a strong sense of nostalgia for the past, often accompanied by a sadness and loneliness when the future is considered.

Some older adults have difficulty concentrating because of outside situations and events. Caregiving responsibilities, the illness or loss of a spouse, changing roles in different social groups (particularly the family), bouts of depression, and the side effects of medication can affect their ability and interest in tasks.

Nursing Homes and Assisted Living. Many in this age group require long-term care in their homes, assisted living facilities, or nursing homes because of fragile health. Long-term care insurance and Medicare supplement insurance are important issues as an older person deals with the effects of aging.

Desire to Leave a Legacy. The next generation takes on a new importance when people reach old age. A reconciliation of spiritual values and a final conclusion as to the meaning of life often prompt a desire in older persons to leave a legacy to the next generation. They attempt to pass on their wisdom and knowledge about life. The liquidation and distribution of any remaining estate is important. For many, finding the proper way to pass assets on to children and grandchildren is the most important objective. Many older adults will want to contribute to a favorite charity. There are significant sales opportunities for charitable, financial, and estate planning.

Common Needs

Updated Will. As with all ages, a properly executed will ensures that an older person’s estate is dealt with in the manner he or she desires. By this phase in the life cycle, if a will has not been updated, beneficiaries may have predeceased your client, or relationships with the beneficiaries may have changed, making the will out of date. An advisor can provide good service by reminding clients to create, or by this phase in life, update an existing will. Advisors must remember the prohibitions against the unauthorized practice of law, and clients should be referred to an attorney skilled in elder law.

Lifetime Income. One of the biggest concerns for many people in the old-age market segment is the possibility of outliving their assets. The majority of old-age prospects and clients realize that Social Security is not adequate to sustain their desired standard of living. This need is even more acute for those who do not receive pension benefits from an employer.
If prospects have not purchased an immediate annuity already, they ought to consider it, especially if they are healthy and longevity runs in their family. An immediate annuity provides lifetime income. For fixed products, the income is level and guaranteed. Together with Social Security, the immediate annuity can help provide a basic standard of living that the annuitant cannot outlive.

**Gifts to Children or Grandchildren.** Some members of the old-age market segment will want to leave a legacy to children and/or grandchildren. This objective may be achieved through bequests at death or gifts made during one’s life.

Bequests at death may involve the distribution of assets, such as a house or investments and savings. Life insurance proceeds are another method for creating a legacy. The prospect or client should be encouraged to update the beneficiaries on any existing policies. Life insurance enables the prospect to increase the value of the bequest, as a dollar of premium purchases more than a dollar of death benefit. The interested prospect who can afford and qualify for a new policy should consider this option.

For most prospects in this stage of the life cycle, purchasing life insurance is too expensive. From this standpoint, many people in the old-age market are not good prospects for insurance for themselves. However, for those who would like to pass on a gift to their children or grandchildren, life insurance remains a method.

A good way for a grandparent to show his or her love for a child is to purchase permanent life insurance on a grandchild, thereby starting that child’s life insurance program at an early age. By the time the child becomes a young adult, the cash value of that permanent plan can prove useful. It could provide the down payment on a home or an emergency fund. When that child eventually reaches retirement, it could be a source of supplemental income. With the addition of a guaranteed insurability rider, this policy could also guarantee the ability to purchase additional insurance in the future.

**Working with Older Persons**

We must be careful not to let stereotypes—that old age adults are unable to learn, are slow to understand new concepts, are confused, unable to concentrate, and so on—get in the way when working with our older clients. Ageism is defined as stereotyping and discrimination against a person on the basis of age. Stereotypes are a composite of attitudes and beliefs about people as a group. When people act based on these beliefs, they can be guilty of age discrimination.

In working with older persons, present your information in the context of their lives, not as isolated items. Do not overuse facts or statistics. Present only the most significant information. Give mature adults an overview, and
let them know what to expect in terms of what will be covered and how long it will take (this is recommended for people of all ages). Seniors are excellent at understanding the big picture because of their life experience and knowledge. Break a presentation down into smaller segments. Encourage interruptions and reviews as you progress. Older people like to ask questions. Slow down your presentation. Provide handouts so they can review them at their leisure. Do not ask them to complete worksheets or other complex tasks, especially with time constraints. They need to be able to work at their own pace. Be aware that some older persons may have a decreased ability to hear and see well.

**Approaching Senior Prospects through Seminar Marketing**

Seminars are a proven strategy for prospecting in the senior market. Unlike other prospecting methods, seminars appeal more to the senior market than to other personal markets. Typically, seminars appeal to prospects who need information and have the time to seek it—a description that fits older prospects.

In general, seniors feel a heightened need for information when making decisions, especially financial ones. Whether they are pre-retirees or retirees, they are looking for safety, security, and ways to avoid unnecessary risks. They understand that time is critically important when it comes to making financial decisions. Younger prospects can afford to make a mistake because they have time to recover from it. Seniors realize they do not have that luxury. Thus, they want to have as much information as they can process before they make financial decisions. Unlike books, videos, web sites, and magazine articles, a seminar enables seniors to interact directly with a financial expert who can answer their questions immediately.

Seniors have more time to devote to finding the information they need. Many seniors have retired or work part time and have the time to attend daytime seminars, which gives the financial advisor the advantage of being able to work with seniors during normal business hours. Even seniors who work full time generally have more time than younger prospects because they no longer have dependent children and the obligations associated with them.

**Seminar Topics**

Four key topics typically generate a great deal of interest among seniors: financing health care, increasing retirement income, reducing taxes, and facilitating estate planning objectives. Relating your products and services to any of these four topics will enable you to use seminars effectively. In some cases, you will need to bring in experts, such as a CPA or eldercare attorney. However, relying on outside experts does not minimize your need to keep
your knowledge regarding these topics current. Continuing education is critical.

**Education and Motivation—Not Manipulation**

Unfortunately, some unethical advisors in the financial services industry have used seminars to exploit seniors. Therefore, it is important to maintain the purpose of the seminar, which is to impart information. This is the implicit promise you make when you send a seminar invitation, so be sure to keep it. The seminar’s purpose is not to make an on-the-spot sale.

Your goal, rather, is to enlighten seminar attendees by making them aware of the exposures they face. For example, a seminar on health care can give attendees information on Medicare nursing home benefits. Many seniors are still under the false impression that Medicare will take care of their long-term care needs. Once they realize the limitations of the Medicare system, they are more likely to seek alternatives, such as LTC insurance, for funding their long-term care needs.

Educating seniors in a seminar setting facilitates the eventual sales process. Prospects can get the facts from which to draw their own conclusions. This reduces the time you must spend educating seniors on their needs during face-to-face appointments. When you make the individual appointment, you can then devote more time to work on ways to meet specific objectives. The seminar education process, in effect, maximizes a financial advisor’s time.

**Summary**

This ends our review of the life cycle. You can see that throughout the life cycle there are ever-changing insurance and financial needs. Because of the dynamic nature of these needs, you have opportunities with prospects and clients to help them to understand, plan, and protect their financial futures and dreams.

**ESTATE PLANNING**

Throughout this textbook, we have examined many planning concepts. They are interdependent and are parts of the larger discipline of financial planning. This section provides an overview of some basic estate planning concepts that affect the overall planning process for all prospects and clients, especially those with a high net worth. We begin with a review of how property passes at death. We then discuss federal estate and gift taxes, and how life insurance can be used to achieve estate planning goals.
What Is Estate Planning?

There is a common misconception that an estate is only the property that one leaves at death. In reality, the estate is much more than that. In its broadest sense, the term estate planning encompasses the accumulation, conservation, and distribution of an estate. The overall purpose of the estate planning process is to develop a plan that will enhance and maintain the financial security of the client and family, and carry out his or her final intentions at death. Estate planning has evolved to include lifetime financial planning that may lead to an increase in the client’s estate as well as the conservation of existing assets. Estate planning should provide financial security during retirement years, and facilitate the intended and orderly disposition of property either during one’s lifetime or at death.

Although many people consider that the primary goal of estate planning is to reduce and/or minimize estate transfer taxes, frequently the central issue is accomplishing the goals of the client for the distribution of assets after death. Financial advisors should seek to optimize the client’s goals in light of tax considerations, rather than to simply maximize tax deductions. Advantages of effective estate planning are in Figure 8-1.

**FIGURE 8-1**
Advantages of a Well-Planned Estate

- Property distribution according to the decedent’s wishes
- Tax-saving options
- Appropriate ownership of assets
- Disability and last illness preparedness
- Liquidity needs assessment
- Personal peace of mind

Advisors often find that clients are reluctant to engage in estate planning because they consider anticipating their own death to be morbid. Procrastination, as with many aspects of financial planning, is a frequent obstacle. Additionally, family issues such as blended families resulting from second or third marriages will make it difficult for some clients to decide how to treat their own children and stepchildren equitably. Frequent obstacles to effective estate planning are shown in Figure 8-2.
FIGURE 8-2
Obstacles to Effective Estate Planning

- failure to plan for death
  - not executing or updating a will
  - not taking the time to think about who gets what and when
  - believing the state succession statutes will cause property to pass the way the estate owner would want it to
- outdated plan
  - birth and death of family members
  - tax law changes
- overlooked provisions
  - guardianship
  - simultaneous death of spouses
  - tax apportionment
- improper tax planning
- improper ownership of assets
- failure to plan for disability, illness, or changes in or loss of employment
- failure to consider inflation
- lack of liquidity
- psychological factors
  - dealing with mortality
  - procrastination

How Property Transfers at Death

Generally when a person dies, property he or she owned will pass to heirs in one or more of the following ways:

- by operation of law. A typical example of this method is a home owned jointly (with right of survivorship) by a husband and a wife. At the death of the first spouse, the surviving spouse gains full ownership of the jointly held property. Property not passing by contract, a will, or operation of law passes under the laws of intestate succession.
- by right of contract. The prime example of this is life insurance that is paid directly to a named beneficiary. Other examples include annuities, Individual Retirement Accounts (IRA), and qualified retirement plans such as a 401(K).
- by will. If there is a will, the remaining property passes under the terms of the will once it has been admitted to probate. If there is no
will, remaining property passes according to the state’s laws of intestacy.

- by trust. A trust is an arrangement in which a trustee administers your assets for the benefit of others in a manner that you specify.

**Wills**

Everyone who owns property should have a will whether single or married, old or young, healthy or infirm. A will is a legal declaration of an individual’s wishes for the disposition of his or her property at death. It describes matters to be taken care of after death. The will becomes legally enforceable at death and is not operative until that time. Prior to one’s death, a will may be amended, revoked, or destroyed by the maker at any time.

Younger couples should name a guardian in their wills to care for their minor children in the event they become orphaned. Another crucial function of the will is to designate someone as the estate’s executor. This is the person who will be responsible for taking inventory of all property, paying estate taxes and creditors, and ultimately distributing the probate estate among the heirs.

**Dying Intestate.** When a person dies without a will (intestate), the courts take control of the estate and, in effect, write a will in accordance with the state’s intestate laws. It is unlikely that the state’s distribution would match most people’s personal wishes. For example, in most states a spouse does not automatically inherit all property when there are children. One state’s intestacy law awards a spouse $4,000 plus one-third of the balance of the estate. The rest is evenly divided among the children, regardless of their ages or any special needs. In most cases, that distribution is not what the deceased person desired, and dying intestate may create severe hardships for the surviving spouse.

In the absence of a will, the probate court must also appoint an administrator of the estate and a guardian for minor children. Normally, the court prefers a relative as administrator, but if one is not available or willing to serve, the estate could end up in the hands of a professional administrator. This official generally charges 3 to 5 percent of the estate in fees each year. This arrangement offers little incentive to settle an estate quickly or to minimize the estate for tax purposes. The court would also select a relative as guardian if the children were orphaned, but without any guarantee of the choice the parent might have made. Because the court’s appointment does not carry the moral weight of the parent’s wishes in a will, children could become the object of a prolonged and acrimonious custody battle.

**Helping Clients Obtain a Will.** Considering the anguish it prevents, a will is a bargain. If the estate is simple, a person can expect to pay $300 to
$500 to have an attorney draw up a will (including a general power of attorney, health care proxy, and living will). You should advise your clients and prospects to have a will prepared as soon as possible.

No one should undertake to make a will without legal assistance. Regardless of how simple and straightforward the individual’s wishes may be, one small error can void the whole effort. Consulting an attorney within one’s resident state assures that all details comply with the laws of that state. The attorney should be familiar with the applicable state laws and should draft the will according to the state law and the wishes of the testator (person making the will).

As a financial advisor, you are uniquely positioned to assist your clients by helping them focus on the dangers and uncertainties of not having a will. Point out that the client’s family can be best served by careful planning and proper execution of a valid will. At times, it is difficult to face up to this disagreeable task, but it must be done and will save the family much grief at the death of a loved one.

**The Requirements of a Will.** The will must meet technical and legal requirements, such as the following:

- The testator must be of legal age as defined by the state (age 18 in most states).
- The testator must be mentally competent and not under duress at the time the will is executed.
- It must be in writing and properly executed according to the state’s laws.
- The will must be signed to indicate intent.
- It must be attested to (verified) by the appropriate number of witnesses (varies by state).

The will does not take effect until the death of the testator. Therefore it can be changed at any time during the life of the testator. A new will can be written to revoke prior wills.

Because only the original will is valid, it is important to keep it in a safe place that others know. A bank safe-deposit box is not suggested because access to it is often restricted. Only limited copies of the will should be made and distributed. The original should be left with the estate executor or attorney for safe keeping.

**Probate**

Whether a person writes a will or not, at death an individual’s worldly effects are generally subject to the legal process known as probate. *Probate* is
the act or process of proving a will. To probate the will means to prove to the court that the document presented is the last will of the deceased person. The jurisdiction of the probate court extends only to the probate assets of the decedent. Probate assets are the property that passes under and is subject to the terms of the will or, if no will exists, the property is subject to administration by the court due to intestacy.

At this time the executor, or the court-appointed administrator, values the assets, pays off creditors, files estate tax returns, and pays taxes (if any are due), and finally distributes what is left to the heirs. Probate occurs under the supervision of a local court known in different states as probate, surrogate, or orphan’s court.

In addition to approving the will—or applying the state’s laws of intestacy for the person who died without a will—the probate court rules on the legitimacy of creditors’ claims against the estate and supervises the actions of the executor until all business of the estate is completely settled. If minor children inherit any property directly, the court also oversees the guardian’s use of that property until the children reach legal adulthood. All guardians, including the child(ren)’s surviving parent, must keep records of their routine use of the child(ren)’s inheritances and must petition the court for any unusual expenditures on the child(ren)’s behalf. It is not a good practice to leave property to minors. A contingent trust for life insurance proceeds is often a sensible alternative.

A major problem with probate is that even with an efficient court and executor, the process takes a minimum of four to eight months. If disgruntled relatives contest the will, or if property was owned in another state, heirs might have to wait longer, sometimes even years. Administrative and legal expenses during probate may run between 5 and 10 percent of the estate. Naturally, the longer an estate lingers in probate, the greater the costs.

**Trust**

A trust is a legal vehicle with four key components: corpus, grantor, trustee, and beneficiary. The property transferred into the trust is called the trust corpus. The person who transfers the property into the trust is called the grantor. The person for whom the trust assets are to be used is called the beneficiary. The trustee holds and manages the corpus for the benefit of the beneficiary, according to a trust agreement. The trust agreement is a contract between the grantor and trustee, who will have actual legal ownership of the trust corpus, which is the cash, or property in the trust. The trust agreement contains the directions to the trustee from the grantor regarding what can and cannot be done with the trust.

A *revocable living trust* is generally established to avoid the cost and the public nature of
probate. By transferring ownership of all you own to the living trust, you avoid the costs, the time lag, and the public record aspects of probate.

In a broader sense, the living trust is more like a will, except that it bypasses probate. A will is still needed to direct possessions not included in the trust, whether intentionally or inadvertently. The living trust focuses on the management and distribution of assets during both life and death. It does not have tax savings as an objective. An attorney prepares it. The owner retains full control, and it is revocable and amendable at any time. Since the living trust is revocable, the trust assets are fully included in the estate at the owner’s death.

The living trust can include decisions about what the owner wishes to take place in the case of disability or death. The owner names someone to be responsible for the distribution of property and can include advance directives that indicate his or her wishes in advance of a medical crisis.

Everything that is to pass through the living trust must have its title changed to ownership by the trust. This includes any property the owner wishes to include, such as real estate, vehicles, stocks, and other investments. Most personal property lacks formal title documents, so the trust instrument simply uses wording that sweeps all of the non-titled personal property into the trust.

The potential advantages of a revocable living trust include the following:

- **Asset control**—the owner has a way of controlling assets in good or poor health. There is no judicial interference or supervision, even in the case of incompetence (such as in Alzheimer’s disease). This control can be extended through the use of a durable power of attorney.
- **Indefinite life**—the trust vehicle is designed to survive the death or disability of the grantor, or even the trustee or successor trustee, through the trust terms.
- **Protection against mismanagement**—As opposed to court-appointed supervision, the grantor of the living trust can select a trustee based on business acumen, expertise, and trustworthiness. A relative or friend and a professional trust company can serve as cotrustees to form an internal checks and balances system within the trust.
- **Effective planning vehicle**—Where minor children or grandchildren are involved, the living trust provides both management and distribution of assets during the child(ren)’s minority. This contrasts with the delays that can occur through the judicial process when a guardian is appointed to manage the assets of minor(s). The living trust can also be designed to deal with specific needs of each minor.
It can also deal with physical incapacity or mental incompetence among the heirs.

- **Achieving privacy**—the probate process leaves financial and personal matters exposed to public scrutiny. A living trust enables a person to avoid this public process completely.

- **Reduce or eliminate probate expense**—Probate costs result from court supervision according to state statute. Executor commissions and attorney fees are generated.

- **Avoid delays in estate administration**—Property distribution may be time consuming, depending on the complexity of the estate, will disputes, and the jurisdiction.

The components of a living trust include the following:

- **Pour-over will.** The pour-over will is a short will containing provisions specifying which assets are transferred to a living trust. It can also state that any property inadvertently left out of the living trust be brought in at death. The property is then distributed as part of the living trust plan.

- **Power of attorney.** A power of attorney (POA) is a document legally signed by one person authorizing another person to act on behalf of the signer. For example, a POA can be used at a house closing when one spouse cannot be present, or to allow a parent to give an adult child access to a bank account. Rather than have an elderly parent travel to the closing of the family home, a daughter with a POA can help a senior manage his or her day-to-day affairs.

There are two types of powers of attorney: a general power and a durable power. A general power is effective as long as the person granting the power remains in good health. Failing health is often a reason for using powers of attorney, but a general power becomes legally ineffective in cases of mental incompetence or medical incapacity. Durable powers of attorney solve this problem by allowing designated family members or advisors to step in and manage financial affairs at the point of the grantor’s incapacity.

Advisors should know that while a revocable living trust has several advantages (privacy, avoidance of probate, and so on), it does not protect a person’s assets from Medicaid spend down if the owner of the trust needs long-term care. Because the living trust is revocable, Medicaid will require that assets in the trust be used to spend down (or self pay) for nursing home care before the owner of the trust can qualify for Medicaid assistance. Unfortunately, some seniors have established revocable living trusts with the belief that their assets in the trust would be protected from Medicaid spend-
down requirements. This is another complex area, and advisors must be familiar with state and local Medicaid regulations.

Advance Directives. Individuals by law have a right to make their own medical choices based on personal values, beliefs, and wishes. But what happens if a person has an accident or suffers a stroke and can no longer make decisions? Would the person want to have his or her life prolonged by any means necessary, or would he or she want to have some treatments withheld to allow a natural death? Usually advance directives will go into effect only when the person cannot make and communicate his or her own health care decisions. Preparing an advance directive lets the physician and other health care providers know the kind of medical care the individual wants, or doesn’t want, if he or she becomes incapacitated. It also relieves family and friends of the responsibility to make decisions regarding life-prolonging actions.

There are two kinds of advance directives:

- **Living will.** A living will is a legal document that describes the types of medical treatment an individual wishes to receive and chooses not to receive. The purpose of a living will is to let others know of your medical wishes when you are terminally ill and in a vegetative state or unable to communicate.

- **Health care proxy, or health care power of attorney.** This is also a component of a well-drafted living trust. A living will makes the medical treatment wishes of a person known. A living will does not guarantee that these wishes will be followed. Someone still has to make the necessary decisions about whether to continue treatment. This is a difficult, emotional decision. Sometimes close relatives are reluctant to let their loved one die. A health care proxy is a signed and witnessed legal document in which an individual names another person to make medical decisions about his or her care. As with a living will, the health care proxy goes into effect only when the person is no longer able to make health care decisions. Sometimes this is incorporated in a durable power of attorney. Depending on state law, which varies widely in directives they officially recognize, it may have to be drafted as a separate document.

Advice to the Advisor

You should prepare a list of three to six attorney’s names that you have researched, along with their fee range, to give to clients or prospects who may need an attorney. It is good to avoid endorsing a single attorney. Give
prospects or clients several good alternatives and allow them to make the choice. This will also protect you from claims of ethics violations, collusion, or poor judgment.

You should establish a network of professionals including attorneys and bank estate planning officers. They will normally welcome an opportunity to work with you, your clients, and prospects, and may even refer their clients to you.

You should develop a working knowledge of the laws of intestacy and probate for your own state. This will provide a source of motivating or disturbing questions for complacent prospects, and you will know about possible solutions and pitfalls. A final caution: these subjects are complex and require the advice of a qualified attorney. Avoid giving advice beyond what you are licensed to do.

**Federal Estate and Gift Taxes**

The federal transfer tax system consists of three components—gift taxes, estate taxes, and generation-skipping taxes. We will discuss gift and estate taxes in the following sections.

The federal estate tax is imposed on the transferor’s estate and is based on the privilege to transfer property. Inheritance taxes, found at the state level, are taxes to the recipient of property based on the privilege to receive property by inheritance. To avoid estate tax-avoidance schemes to dispose of property during lifetime, the federal tax system is coordinated with the federal gift tax, which is a tax imposed on transfers of property by gift during the donor’s lifetime.

**The Federal Estate Tax**

The federal estate tax is calculated on the value of the property transferred at death. It is a tax on the right to transfer the property; it is a graduated tax beginning at 18 percent. The tax then builds up to a maximum percentage that is changing each year from 2002 to 2009 for amounts of $3.5 million and more. Apart from congressional action in 2009 (which is probable), the federal estate tax is to be repealed for 2010 and return in 2011 using 2001 tax rates and limits. The tax rate in 2011 would return to 55 percent on taxable estates greater than $1.0 million or more.

Individual states may impose an additional inheritance tax on the assets of the deceased that are received by the estate’s heirs. It can be arranged to have the estate pay inheritance taxes to protect the interests of the heirs.

**Taxable Estate.** The taxable estate is the value of all property or partial interest in property, owned or controlled by the deceased, reduced by allowable deductions. These allowable deductions include reasonable funeral
expenses, administrative expenses (court costs, attorney/executor fees),
claims against the estate, unpaid mortgages, debts, as well as bequests to
charities and the surviving spouse.

Three additional deductions are allowed: the marital deduction, the
charitable deduction, and the state death tax deduction. These will be covered
shortly.

As you may know, the details regarding the calculation of estate taxes
can get quite complex. For example, determining what property is includible
in the estate is not that straightforward. There are intricate rules that often
bring property that the deceased did not own outright at the time of death
back into the taxable estate.

**Marital Deduction.** An important part of estate taxes is the marital
deduction provision that permits a deduction of 100 percent of property
passing to a spouse either by gift or at death. To qualify for the deduction, the
property generally must pass to the surviving spouse in such a manner that he
or she has sole power of control during life or at death. In effect, the estate of
one spouse can be passed to the other completely free of taxation, as long as
it qualifies for the marital deduction.

Although there are exceptions to this general rule, further discussion is
beyond the scope of this textbook. In effect, using the marital deduction is
merely a postponement of taxation at the death of the first spouse. The
property that passes to a surviving spouse will be taxable at his or her
subsequent death. Much estate planning is directed toward minimizing this
result.

**The Charitable Deduction.** An estate tax charitable deduction is allowed
for the full value of property transferred to a qualified charity, but only if the
property is included in the donor’s gross estate. The charitable deduction
allows an unlimited deduction for assets passing to a qualified charity. Examples of qualified charitable organizations include corporations
operating exclusively for religious, charitable, scientific, literary, or
educational purposes.

**State Death and Inheritance Taxes.** Many states also impose state death
and inheritance taxes on the transferred property of the deceased. In some
states, this is an estate tax. In other states it is an inheritance tax that taxes the
share received by the beneficiary.

Frequently, the consideration of state death and inheritance taxes is
overshadowed by the attention given to the federal estate tax. Ironically, the
federal estate tax affects a very small percentage of all estates, whereas most
estates are within reach of state death and inheritance taxes. Learn how your
state’s death and inheritance taxes work. Your clients will appreciate the
information and may be open to discussing your ideas about how to plan for this, such as buying life insurance to meet the corresponding expenses.

Until 2005, the federal estate tax gave a state death tax credit. However, this provision was repealed by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). Beginning in 2005, the state death tax credit is repealed and replaced with a deduction for any amount of state death taxes paid. This change has caused many states, especially those states with only a federal estate death tax credit, to legislate new state death tax laws.

### 2001 Federal Estate Tax Law Change

As changed by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)

<table>
<thead>
<tr>
<th>For Decedents Dying During</th>
<th>Top Estate Tax Rate</th>
<th>Applicable Unified Credit Amount</th>
<th>Exemption Equivalent</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>50%</td>
<td>$345,800</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>2003</td>
<td>49%</td>
<td>$345,800</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>2004</td>
<td>48%</td>
<td>$555,800</td>
<td>$1,500,000</td>
</tr>
<tr>
<td>2005</td>
<td>47%</td>
<td>$555,800</td>
<td>$1,500,000</td>
</tr>
<tr>
<td>2006</td>
<td>46%</td>
<td>$780,800</td>
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<td>2007</td>
<td>45%</td>
<td>$780,800</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>2008</td>
<td>45%</td>
<td>$780,800</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>2009</td>
<td>45%</td>
<td>$1,455,800</td>
<td>$3,500,000</td>
</tr>
<tr>
<td>2010</td>
<td>Repealed</td>
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<td>N/A</td>
</tr>
<tr>
<td>2011</td>
<td>55%</td>
<td>$345,800</td>
<td>$1,000,000</td>
</tr>
</tbody>
</table>

**Applicable Credit Amount.** Once the taxable estate is calculated, the estate tax is figured. From this amount, the estate can subtract the applicable credit amount. The credit is an amount that can be applied directly against any gift or estate tax due. This amount is $1,455,800 in 2009. This means that a person with assets less than $3.5 million dying in 2009 generally will have no federal estate tax payable. The $3.5 million is called the exemption equivalent. Note that without further Congressional action, the tax is set to repeal in 2010 and return in 2011. However, it is anticipated that the Congress will take action on the estate tax law in 2009.
The applicable credit amount coordinates the estate and gift taxes. In other words, whatever portion of the applicable credit amount someone uses during his or her lifetime to gift substantial sums of money will reduce the amount of the applicable credit available for estate tax purposes. The applicable credit for gift tax purposes is $345,800 based on an exemption equivalent of gifted property of $1,000,000.

**Federal Estate Taxation of Life Insurance**

The death proceeds of life insurance owned by the decedent or the decedent’s estate is fully includible for estate tax purposes. This is true even if the proceeds are to be paid directly to a named beneficiary. If the decedent had owned a life insurance policy on someone else’s life, meaning the decedent was not the insured, the cash value of that policy would also be included in the decedent’s estate.

Frequently, life insurance is the single largest asset or group of assets in the gross estate. Including life insurance can often mean the difference between having a federal estate tax liability and having none. For this reason, it is important to know when life insurance is included in the decedent-insured’s gross estate for federal estate tax purposes. Factors include the following:

- Life insurance proceeds payable to the executor (that is, to or for the benefit of the insured’s estate) are includible in the estate, regardless of who owned the contract or who paid the premium.
- Life insurance proceeds are included in the estate of an insured if the deceased possessed an incident of ownership in the policy at the time of his or her death.
- Life insurance proceeds are included in the gross estate of a deceased insured who transferred incidents of ownership in the policy within three years preceding his or her death.

**Life Insurance Payable to the Executor.** In general, life insurance should not be made payable to a decedent’s estate. There are many reasons besides avoiding federal estate taxation why estate planners seldom recommend such a beneficiary designation. Reasons include the following:

- Insurance payable to a decedent’s estate subjects the proceeds to the claims of the estate’s creditors.
- Insurance payable to a decedent’s estate subjects the proceeds to costs of probate administration, such as executor’s fees, but provides no corresponding advantages.
Possession of Incidents of Ownership. Incidents of ownership refers to a number of rights to, and degree of control of, the policyowner or the policyowner’s estate in the economic benefits of the policy. Examples of contractual rights that reflect incidents of ownership include the following:

- the right to surrender or cancel the policy
- the right to make policy loans
- the right to assign the contract
- the right to name and change the beneficiary

Ownership and the Three-year Rule. One strategy for decreasing the value of an estate is to transfer ownership of life insurance from the estate owner to some other person or a trust. However, the value of any life insurance is included in the estate if the transfer is for less than full consideration (for example, a gift) and occurs within three years prior to the death of the owner. Therefore, one must relinquish all incidents of ownership and remain alive for at least three years after the date of transfer for the life insurance to avoid inclusion in the estate. Note that a sale to a third party for the full fair market value of the policy will not cause the death benefits to be included, even if the sale occurs within three years of the insured’s death.

Example: Brenda, a widow, transferred ownership of three whole life insurance policies to her daughter, Sara, six years ago. However, it was clear at the time of the transfer that Brenda still had the right to borrow against the policies’ cash values and the right to change the beneficiary by written notification to the insurance company. Although Brenda effectively transferred title in the policies to her daughter, the policies’ proceeds will still be included in her gross estate for federal estate tax purposes because she retained the right to borrow against these policies and to change the beneficiary. To have successfully removed the proceeds from the gross estate, Brenda should not have reserved these rights.

For new life insurance policies, the best approach to keep the policy out of the insured’s estate is for another person or an irrevocable trust to own it outright from inception. No three-year rule applies if the insured never possessed incidents of ownership in the policy.
Uses of Life Insurance in Estate Planning

Insurance Used to Increase Estate Value. The ways life insurance can be used in estate planning depend upon the client. For most people, life insurance is bought to provide for surviving family members. These are the clients that most of us serve. It could be the young family buying insurance as income replacement, to fund college educations for their children, to provide for mortgage redemption, or to build a nest egg for retirement. Life insurance provides the immediate estate to replace income if the breadwinner of the family should die prematurely.

Insurance Used to Provide Estate Liquidity. For older clients and those who have built wealth, life insurance is often used to provide estate liquidity. Their children’s support and educational expenses are usually no longer their obligations. In addition, these older clients are nearing the end of their income-producing years, and should have less future income to replace. They can purchase life insurance to provide death proceeds equal to the size of the anticipated shrinkage of their estate due to settlement and taxes. The estate liquidity/wealth replacement needs include the following:

- **Probate expenses.** Estate settlement costs usually increase with the size of the estate. The cost for professionals, such as executors, attorneys, accountants, and appraisers, to settle an estate is often based on a percentage of the total size of the probate estate. Generally the larger the estate, the greater the complexity and need for expensive professional help. One excellent advantage of life insurance is that it avoids probate if paid to a named beneficiary.
- **Death taxes.** As discussed above, federal estate taxes and other taxes also increase with the size of the estate. Federal estate taxes (and state death taxes in many states) are based on a progressive rate schedule. Thus, wealthy individuals often desire life insurance to replace the wealth lost to death taxes.
- **Liquidity needs.** Wealthy clients often face an additional problem. Frequently, their accumulated wealth contains assets that are not liquid. For example, wealthy individuals often own closely-held businesses or real estate that may be illiquid or unmarketable to outsiders. Death taxes and other estate settlement costs are based on the full value of such assets owned by the estate and must be paid in cash. The liquidity problems faced by an estate often result in the forced sale of estate assets on undesirable terms.

An estate must normally be settled in nine months after the owner’s death. The liquidity of life insurance provides a ready fund for this. Other
assets which cannot be easily liquidated are protected and preserved for the heirs. This is a common use of life insurance for estate planning.

Life insurance is the most effective way to supply needed dollars to meet federal estate tax obligations. First, the dollars, in the form of death proceeds, are free of federal income taxation. Second, if the life insurance is owned by someone other than the insured (or some entity such as a trust), the policy’s face amount will not be included in the decedent’s gross estate. Finally, as with all life insurance policies, a sizable death benefit may be purchased for pennies on the dollar.

Estate Planning Techniques

Among the practical uses of life insurance in estate planning are the following:

- **Transferring policies to family members.** When the three-year rule of transfer is not met, no greater penalty will occur than the inclusion of the policies back into the value of the estate. The insured/owner will be no worse from an estate tax standpoint because the policy would have been included if the transfer had not occurred.

- **Creating irrevocable life insurance trusts** (ILIT). These are often used in estate planning for wealthy individuals to provide estate liquidity. The irrevocable trust should be set up before an application for life insurance is submitted. If the application is written prior to the trust’s existence, the government treats it as a transfer of ownership and the three-year rule applies. By having the trust serve as applicant, owner, and beneficiary of the life insurance policy, the insured possesses no incidents of ownership, and the proceeds will not be included in the insured’s estate.

- **Creating revocable trusts.** These are sometimes used to receive the proceeds of life insurance to ensure proper management of the distribution of assets. An example would be a family situation where a spouse and young children were to be protected. The revocable trust is designed to become irrevocable at the death of the grantor, and a trustee manages the proceeds for the benefit of the remaining family members. The proceeds are includible in the estate of the deceased grantor.

- **Equalizing inheritance among heirs.** An example is a family business where one or several children will inherit the enterprise, and other family members will be excluded. Life insurance is frequently purchased to provide an equal inheritance for children who would be excluded from the business inheritance.
Example: Marcus is president and sole shareholder of Zipper-Do, Inc., a highly successful manufacturer of snag-proof zippers. He has three adult children—two sons and one daughter. The daughter and one of the sons work for Marcus and would like to take over the business when Marcus retires. The other son, a musician, has no interest in the business. Marcus arranges for the two employee-children to receive the business at his retirement or death. He also acquires life insurance on his life in an amount equal to the anticipated fair market value of Zipper-Do, Inc. that each employee-child will receive. Marcus pays the premiums, and the musician son is the designated beneficiary of the policy. Equity of inheritance has been achieved.

- Creating survivorship life insurance plans. With the federal estate tax unlimited marital deduction, taxes are postponed but not eliminated. The estate values from the first marriage partner’s death are added to the second partner’s assets at death, usually leading to a higher overall tax when the second partner dies. Greater planning is needed for the second spouse. The survivorship life insurance plan, also commonly called the second-to-die plan, is designed to protect the overall estate by creating liquidity at death. It jointly insures the husband and the wife, and proceeds are not paid until the death of the second spouse. The proceeds provide needed estate liquidity. When children or a trust owns the policy, the proceeds will be paid outside the estate and escape estate taxes.

Gift Taxes

The gift tax is a federal tax on an individual’s right during life to transfer money and property by gift to others. It is levied on the donor. The annual exclusion for 2009 is $13,000 (inflation-adjusted in $1,000 increments) to each donee, provided the gifts are outright and of a present interest. A present interest means the gift is complete, transferred for less than full and adequate consideration, and the donee (recipient of the gift) has full possession and the immediate right to use, possess, and enjoy the gift.

A person is entitled to give annually to any number of recipients with no gift tax payable, up to the annual gift tax exclusion amount. For a married couple, each spouse can give up to the annual exclusion per recipient and together exclude two times the annual exclusion per recipient. This is referred to as a split gift and a gift tax return must be filed to accomplish this. Therefore it is possible to transfer significant amounts of property out of an
Techniques for Exploring Personal Markets

estate during one’s lifetime, without a gift tax. As a practical matter, most
people limit their lifetime gifts to small amounts and only to their children
and grandchildren.

<table>
<thead>
<tr>
<th>Calendar Year</th>
<th>Exemption Equivalent*</th>
<th>Top Gift Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>$1,000,000</td>
<td>50%</td>
</tr>
<tr>
<td>2003</td>
<td>$1,000,000</td>
<td>49%</td>
</tr>
<tr>
<td>2004</td>
<td>$1,000,000</td>
<td>48%</td>
</tr>
<tr>
<td>2005</td>
<td>$1,000,000</td>
<td>47%</td>
</tr>
<tr>
<td>2006</td>
<td>$1,000,000</td>
<td>46%</td>
</tr>
<tr>
<td>2007</td>
<td>$1,000,000</td>
<td>45%</td>
</tr>
<tr>
<td>2008</td>
<td>$1,000,000</td>
<td>45%</td>
</tr>
<tr>
<td>2009</td>
<td>$1,000,000</td>
<td>45%</td>
</tr>
<tr>
<td>2010</td>
<td>$1,000,000</td>
<td>35%</td>
</tr>
<tr>
<td>2011</td>
<td>$1,000,000</td>
<td>55%</td>
</tr>
</tbody>
</table>

* This is a lifetime transfer exemption applying to gift taxes.

Gift taxes are levied only after someone exhausts the lifetime gift
exemption equivalent of $1 million. Any use of this lifetime gift exemption
equivalent will reduce the applicable credit amount available for gift and
estate tax purposes by the amount of the corresponding gift tax.

Note that only the gift tax amount associated with gifts that exceed the
annual gift tax exclusion will reduce the applicable credit amount. For
example, if during the course of a year, a single mother gives $40,000 to her
son, no taxes will be due on the $27,000 that exceeds the annual exclusion
(for 2009) as long as she has not exceeded the $1 million lifetime exemption
equivalent for gifts. The net effect is that her applicable credit amount for gift
and estate tax purposes would be reduced by the gift tax amount associated
with this $27,000 gift. The exception would be donations to charities, which
do not reduce the applicable credit amount. 

Charitable Gifts through Life Insurance. People make gifts to their
favorite charities because they believe in the work of the charity and because
they want to do something good. Unfortunately, for most of us, the amount
we can give is limited and we are influenced by the tax benefits of our gifts.
The use of life insurance to fund a charitable gift has many advantages.
Charitable gifts can produce three federal tax benefits:

- income tax. When the donor itemizes deductions, charitable donations during the donor’s lifetime are usually deductible.
- gift tax. With a few exceptions, qualified charitable gifts or bequests are exempt from gift taxes.
- estate tax. Charitable gifts that become effective after the donor’s death may qualify for an estate tax deduction.

More people are beginning to realize the advantages of using life insurance in a charitable giving situation as an alternative to giving cash or other assets to a charity. Many charities have established life insurance programs that they publicize to their most loyal supporters. Some of the advantages your clients will realize by using life insurance as the vehicle of gifting are

- leveraging the contribution, so it will become a larger gift than otherwise possible with a straight cash contribution. It becomes a gift made on the installment plan through annual premium payments for the life insurance.
- receiving a current income tax deduction for donations made to pay premiums on a policy owned by the charity
- receiving a future estate tax deduction for life insurance proceeds paid to a charitable organization upon the death of the donor
- creating a new asset and not depending upon other owned assets to make the gift
- avoiding the probate process for the life insurance that would create costs, delays, and publicity which connects the charitable gift to the settlement of the estate
- avoiding possible challenges by the potential heirs
- avoiding creditor claims that could be attached to the other assets that pass by will
- creating, through life insurance, a self-completing gift that is fairly simple to arrange

Estate planning is a complex process that requires a significant amount of study, training, and experience. However, in writing even the simplest life insurance policies, these basics must be understood, as these principles of effective estate planning will potentially affect your client’s taxable estate. This section should help you to see opportunities in this area, and to better understand your role in advising your client and using life insurance most effectively in your client’s financial plan. With this information, you can also...
determine whether you want to pursue the skills and knowledge necessary to

target clientele with estate planning needs.

**DISTRIBUTION PLANNING**

Most of your older clients will have several different sources of post-retirement income, including the following:

- Social Security benefits
- tax-advantaged employer plans such as 401(k), 403(b), SEP-IRA
- Individual Retirement Accounts (IRAs)
- investment income from mutual funds, stock dividends, bond interest, rental from investment real estate, and so on
- pensions such as corporate, military, federal, or state employment
- income from trusts set up by the client or for the client’s behalf
- income from part-time work such as consulting

Your client may also inherit assets or be the beneficiary of life insurance policies on others such as a spouse or other relative. These sources of income may be intermittent or last for only a few years. Some income sources are subject to cost of living increases (for example, Social Security benefits and federal pensions), while some will remain level. The task of planning for a client’s income distribution can be very complex, with many moving parts and assumptions about such things as future inflation rates, investment returns, and spending requirements. The entire field of income distribution is evolving into a financial specialty in itself with its own practitioners, associations, and publications. While it is beyond the scope of this textbook to deal thoroughly with the subject, it is safe to say that as a practicing financial advisor, you will have opportunities to assist clients with this important issue. Thus, you will need to know the basics of distribution planning.

Many recent consumer surveys have highlighted the concern that retirees have for their retirement income security. Along with concerns about their personal health, risks of needing long-term care, and loss of their independence, retirees consistently reveal their strong fear of outliving their assets before they die. They know of others who retired with a comfortable middle-class lifestyle in their 60s who were struggling and debt-ridden in their 70s and 80s. Advisors must acknowledge these fears in the older client, and help them take the steps to ensure their future financial success.
Maintaining Purchasing Power

One of the major challenges for older retirees is maintaining the purchasing power of their money, thus maintaining their standard of living. Two major threats to all retirees are inflation and taxes. Inflation is often compared to high blood pressure as a silent killer, as even normal inflation constantly reduces purchasing power of the dollar by increasing costs over time. For example, at a relatively low annual inflation rate average of 3.5 percent, the purchasing power of $100,000 would erode to approximately $70,000 after just 10 years. The costs of many goods and services heavily used by seniors, particularly health care and prescription drug costs, are increasing at rates three or four times the general rates of inflation measured by the Consumer Price Index (CPI). Thus if income sources and investment returns do not increase with time to keep pace with inflation, purchasing power inevitably declines along with the retirees’ standard of living.

Tax rates vary considerably by areas of the nation. However, it is a safe assumption that taxes will increase for nearly everyone over the next decades. The huge need to fund social services for the large baby boomer population, the pressing need for infrastructure improvements, and the economic difficulties of recent years make tax increases inevitable.

Finally the increased life expectancies of Americans make retirement periods lasting 30 or more years a real possibility. Inflation risk will thus be a much greater threat to today’s retirees than it was for their parents or grandparents who normally lived only a few years after they retired. Modern retirement planning must carefully consider longevity issues and seek ways for clients’ income and investments to accommodate inflation over much longer retirement periods.

Cash Flow and Spending Plan

For most of your clients, with the exception of those with considerable wealth, it will be critical to make a careful projection of income and expenses, that is, a cash-flow analysis. This step is often given lip service by some advisors, and many clients are reluctant to develop it because it highlights areas of excessive spending or careless recording of checks and other financial records. There is a valuable discipline required to compile an adequate cash-flow analysis, and it will almost always reap benefits for your clients.

When considering the client’s income, pay special attention to whether the income source is adjusted for inflation. Many older corporate pension plans are fixed, while most state, federal, and military pensions are inflation adjusted. That can make a significant difference in meeting future income needs.
Many advisors find a three-tiered analysis of income goals helpful, which places retirement spending into three categories: needs, desires, and aspirations.

- **Needs**: These include the necessities of life such as food, rent or mortgage, utilities, insurance, and debt repayment. They are expenses which would be the last to go if the client experienced financial difficulties.
- **Desires**: These include convenient, but unnecessary, items such as vacations, cruises, hobbies, gym membership, and gifting to children or charities. These are expenses, which could, and would, be eliminated if the client experienced financial difficulties.
- **Aspirations**: These are dreams a client may have such as returning to college, studying abroad for a year, or leaving a large inheritance to children or grandchildren. While emotionally important to the client, these aspirations may have to be eliminated if financial difficulties occur.

After the different spending categories are determined, the advisor and client will be better equipped to understand the true nature of the client’s financial situation. For example, if secure income sources such as government pension and social security benefits are adequate to meet the basic needs of the client, then additional dollars can comfortably be spent for the desires and aspirations, or they may be invested with greater confidence on the part of the client. On the other hand, if the secure income sources are not enough to meet basic needs, other strategies must be used. For example, some of the client’s assets such as stocks, bonds, or mutual funds may need to be liquidated to provide the additional income.

Advisors must understand that some clients may be at risk by withdrawing too much from their investment portfolios, because they have unrealistic expectations of future market returns. While the specifics are beyond the scope of this textbook, much of the recent research studies project sustainable withdrawal rates of only 4 to 4.5 percent per year from a diversified investment portfolio (for example, a mix of stocks, bonds, and cash). Thus, a client with a diversified portfolio of $100,000 should withdraw only about $4,000 to $4,500 per year (pre-tax) to increase the probability that the portfolio will last over his or her expected life span. This concern for outliving one’s assets has generated interest in immediate annuities.

**Individual Annuities**

More and more advisors are taking a new look at the advantages of annuities to provide secure income to their clients, especially to meet the
basic needs when a shortfall exists. We assume you have a basic familiarity with annuities from your previous studies. In this section, we will review some general definitions and examine alternative payout or settlement options—different ways to structure annuity payouts. Remember, these same annuity payout alternatives can be used with life insurance cash values or death benefits, often referred to as optional modes of settlement.

In its most basic form, an annuity is a legally enforceable contract between an individual and an insurance company which can convert assets into an income stream. The income is in the form of regular, periodic payments such as annually, quarterly, or monthly. The income may be guaranteed in some cases for the life of the annuitant (usually the owner), or the guarantee may be for shorter periods.

Annuities can be categorized in several ways. There are immediate annuities and deferred annuities. There are single-premium and flexible-premium annuities. Also there are fixed and variable annuities. These distinctions are briefly described below.

**Immediate Annuity**

An immediate annuity provides periodic payments in return for a lump sum investment of money, with the payments beginning one annuity period (for example, annual or monthly) after the contract issue date.

**Example:** Barbara, a 65-year old widow with no close, living relatives, purchases an immediate annuity for $100,000 from the High Life Insurance Company on January 1st. Her monthly payments of $575 begin one month later on February 1st. With the payout option that Barbara selected, her monthly payments are guaranteed for her life and will cease at her death.

**Deferred Annuity**

With a deferred annuity, the income payments are deferred for a period longer than one annuity period after the contract’s issue date. The period from the initial purchase until income payments begin is called the accumulation period. The payout period, also known as the annuitization period, begins with the first payment to the annuitant.

**Example:** Robert, at age 50, purchased a deferred annuity using a $50,000 inheritance to provide retirement income beginning at age 60. For the 10-year accumulation period, his monthly payments of $500 begin on January 1st.
period, the annuity earned interest which was tax-
derferred under current income tax rules. At age 60, the
value of the annuity was almost $78,000. Robert then
chose to annuitize the contract, and he began receiving
annual payments of $4,600 exactly one year after the
annuitization date. Those annual payments are
guaranteed to Robert for the remainder of his life.

**Single-Premium Annuity**

A single premium annuity is funded by only one lump-sum premium
payment by the contract owner to the insurer. All immediate annuities are
also single-premium annuities.

**Flexible-Premium Annuity**

In contrast to a single-premium annuity, the flexible-premium annuity
allows the contract owner to vary the frequency and amounts of premium
payments into the annuity during the accumulation period. Thus a contract
owner may periodically make both monthly premium payments and
occasional lump-sum payments, perhaps from a tax return or inheritance. All
flexible-premium annuities are deferred annuities.

**Fixed Annuity**

A fixed annuity specifies a minimum guaranteed interest rate which is the
lowest rate the insurer will credit to the contract owner. The current interest
rate, also known as the credited rate, is the rate the insurer pays for a given
period. The current interest rate is equal to or higher than the guaranteed
interest rate.

**Example:**

James purchases a single-premium fixed annuity from
the Very Old Life Insurance Company. The insurer
guarantees a first year interest rate of 5.25 percent, and a
rate of 4.25 percent for years two through six. After the
sixth year, the contract guarantees a minimum interest
rate of 3 percent.

**Variable Annuity**

The variable annuity has accumulation values that fluctuate with the
performance of one of more specified investment funds. The funds may be
managed by the insurer, or they may be provided by outside investment companies. Variable annuities do not guarantee either principal or interest of investment accounts, although many variable annuities have a fixed account option which may pay a low guaranteed rate for a specified period of time.

**Life Insurance Settlement Options**

Life insurance death benefits can be critical for the financial futures of surviving loved ones. In such situations, the proper disposition of the policy proceeds through policy settlement options is important. A number of different options are available. The selection of the specific settlement option may be established prior to death by the policyowner or left to the beneficiary’s choice.

**Lump-sum or Cash Proceeds**

Most payments to beneficiaries are taken as a lump sum. All of the contract proceeds under this arrangement are paid to the named beneficiary in a cash payment by check or, for most companies, into an interest-bearing checking account for immediate use or future disposition. These accounts work much like a check-writing money market fund. The beneficiary can withdraw the total proceeds in one transaction or make partial withdrawals of funds by writing checks. The balance in the account continues to earn interest until withdrawn. Even with these conveniences, over 90 percent of beneficiaries still choose a single lump-sum withdrawal and take possession of all the proceeds.

In deciding whether the proceeds should be paid in a lump sum, remember that this option offers no protection against the creditors of the beneficiary. The choice of other options, discussed later, can provide protection against creditor rights to the proceeds. Lump-sum distributions allow the beneficiary to manage the money, either reinvesting it at a higher rate, using it to pay estate settlement costs or debts, or for any purpose they choose. For many beneficiaries, however, especially those who are relatively inexperienced in money management, receiving guaranteed payments in installments may be safer and more desirable.

**Supplementary Contract**

When proceeds are to be paid under one of the settlement options, other than the cash settlement, a new contract called a supplementary contract is issued. Insurance companies guarantee the safety of the funds and keep them invested at a contractual rate of return.

The insurance company can prepare illustrations and figures for any of the settlement options you may wish to discuss with a client or beneficiary. A
list of the most common arrangements follows. You will recognize these as the same as those offered in annuity contracts. Most companies permit arrangements not specifically granted in the contract, but are more liberal in working out different settlement plans adopted by the policyowner before death than for unusual requests by a policyowner beneficiary after death.

**Payout Choices**

**Interest Income.** Under this settlement option, the insurer holds the proceeds and makes regular interest income payments to the beneficiary based on a rate of return guaranteed in the policy, or a higher rate based on current interest rates. This selection preserves the capital for the future and protects the capital from creditors of the beneficiary. The option can also be set up to enable the beneficiary to make cash withdrawals from the proceeds at any time. This option is designed to distribute the full proceeds at a later date, when the beneficiary is ready to receive them, or at the beneficiary’s death. The most flexible of all available settlement options, the interest option is also the only one in which income is fully taxable (from the interest, not the death benefit) to the recipient. (Note that with the other options, income is made up of principal and interest and only the interest portion is taxed. We will revisit this later.)

**Fixed Period Income.** Here, the company pays out both policy proceeds and interest earned in installments over a specified period. The income received depends on the amount of proceeds, the interest credited, and the time period selected. The fixed period payout for insurance proceeds offers no flexibility to the beneficiary and is not appropriate unless a clearly-defined purpose and time frame for need can be established.

**Example:** Janice, a 61-year-old widow, recently received a death benefit of $50,000 after the death of her mother. Janice needs income for the next five years to supplement her salary until she retires at age 66 and begins drawing Social Security benefits. As the beneficiary, she chose a settlement option which will pay her $900 per month for 60 months, after which payments will cease. Each monthly payment consists of a taxable portion due to the interest paid by the insurer, and a tax-free portion from the death benefit.

**Specified Amount.** Under this option, policy proceeds, plus interest, are used to pay out a specified amount of income at regular intervals for as long
as the proceeds last. The larger the payment, the shorter the period of income. This option is similar to the fixed period settlement choice except that excess interest above the return guaranteed by the company extends the length of time for the payout. This option is selected when the beneficiary determines that a specific amount of income is needed.

**Example:** Nancy was the beneficiary of a $50,000 life insurance policy on her father who recently passed away. Nancy has determined she would like a monthly payout of $600 per month for as long as the proceeds (and interest accumulations) will last. The insurer provides Nancy a supplemental contract which will guarantee her the $600 monthly payment for 93 months, with a small residual payment of the remaining account value.

**Life Income.** The life income option is a settlement choice unique to the insurance industry. The promise is to pay a stated income as long as the beneficiary lives. At death, the contract ends. This describes a pure no-refund annuity. Whether the beneficiary lives to 110 or dies next year, the annuity reverts to the company at death. Even though it may offer the highest amount of income to the beneficiary during life, this option is used sparingly. A more popular and commonly used life income settlement builds in a refund or period-certain guarantee.

**Example:** Malcolm, a 70-year-old retired factory worker with no living relatives, received a $100,000 death benefit when his wife passed away. Malcolm desired the maximum monthly payout and was not concerned with leaving a legacy. The insurer provided a supplemental contract with a life income option that guaranteed Malcolm an income of $625 per month, which he accepted. After only five years of payments, Malcolm died from a stroke. The value of the annuity reverted back to the insurer.

**Life Income with Refund.** The life income with refund option guarantees payments for the life of the annuitant. If the annuitant should die before all the proceeds have been distributed, the balance of payments would be paid, either in a lump sum or installments, to the annuitant’s beneficiary or even a
third beneficiary, until all proceeds are depleted. The annuitant is assured through this option that all proceeds will be paid out.

**Example:**

Carlos, a 65-year-old retiree, was the beneficiary of a $100,000 insurance policy on his father. Carlos accepted a life-income-with-refund payout from the insurer. Under the contract terms, Carlos is guaranteed a monthly payout of $550 for the remainder of his life. If he should die before the full $100,000 has been paid, the remainder will be paid in a lump sum to Carlos’s daughter Maria.

**Life Income with Period Certain.** Under a life income with period-certain payout option, the annuitant receives payments for his or her entire life. In addition, the annuitant is guaranteed that if he or she should die within a certain period, such as, 10, 15, or 20 years, the payment will be paid to a beneficiary for the balance of the period.

**Example:**

Scott selects a life income option with a 10-year period certain. If he died three years later, his designated beneficiary would receive payments for seven years, which is the balance of the period certain. If Scott should live longer than the 10-year period, he will have income for the rest of his life under the life income portion of the payout. At his death, no further payments are due.

**Joint and Survivor Life Income.** Under this settlement option, income is provided for two people. It is most commonly used by married couples for payment of retirement benefits. It can be set up to expire at the second death or to have the refund or period-certain guarantees built into the settlement. The joint income may be set up so that the survivor’s income continues at 100 percent of the amount paid when both annuitants were alive. This is called a joint and 100-percent survivor income. This can be varied so that survivor income is reduced to a percentage of the full amount. The common arrangements are joint and two-thirds or joint and one-half.

**Example:**

David is the sole beneficiary of a $100,000 life insurance on his sister who recently passed away. David selects a joint-and-survivor life income option which will pay $600 per month to him and his wife Diane while they both remain alive. If either spouse dies, the surviving
spouse will continue to receive 75 percent of the $600, or $450, for the remainder of his or her life. After the second spouse dies, no further payments are made by the insurer.

Other Options

You may find that one option is not enough when the issue is the distribution of large sums of money. For example, estate settlement costs must be paid before proceeds are dedicated to income-producing vehicles such as annuities or an investment. Annuities may be too narrow of a method for managing all funds from a single situation, and other forms of investment may be indicated for diversification. However your clients choose for distribution of cash proceeds from their insurance policies, they should consider three objectives:

- income needs
- growth of principal
- safety of principal

If you are making recommendations on the allocation of the proceeds, you should know these objectives and attempt, through questioning, to understand your client’s views on them.

Death Claims

There is an old observation about death claims. When someone dies, many will come offering sympathy. Many others will come with hands out, because death creates expenses that must be paid. Only the life insurance advisor can come offering financial support at the time it is needed most. You will not fully understand what it means to be a life insurance advisor until you have delivered the first claim check on a policy that you wrote. This role for advisors is an extremely difficult yet important experience. It validates the message you have shared with your clients and prospects in a highly personal, emotional way. In some cases, it is best to delay major decisions until the beneficiary has had some time to adjust to the loss, especially if the deceased was a close loved one.

Respond quickly to deaths of your customers or clients. Although this is a hard time for the family, your help in initiating the claims process will provide a much-needed and appreciated service. Always start a separate client file for death claims. Record the summaries of conversations you have with claims personnel in the insurer’s home office. Do not accept unnecessary delays in processing the claim. Find out early if there are
questions that may delay the claim, such as investigation of an insured’s
death within the policy’s contestability period. Best practice is to not discuss
with family members or beneficiaries exactly how much the death benefit
will be. Remember, the death benefit may be adjusted for outstanding policy
loans, interest payments, misstatement of age or of gender, and other reasons.
When you deliver the first check—and you should do so in person—you will
then know the amount, and you will be able to ease the trauma of the
situation.

In addition, when you contact family members, you may find that they
need your help in filing claims for other benefits to which the deceased was
entitled, such as Social Security, other insurance policies, or veteran’s
benefits. You can assist your clients and customers in this often
time-consuming and confusing chore by providing them written instructions
in advance for filing these claims. These instructions become part of a claims
kit that you prepare and present to your customers during the delivery
interview or at the first product review. In a death claim situation, you may
provide additional assistance by helping clients with the paperwork for these
claims.

**Claims Kit**

A claims kit can include any number of items that will be helpful to your
customers and their surviving family members. The cover letter explaining
the deceased’s life insurance plan, which you discussed during the product
delivery and in subsequent annual reviews, should be in the kit. So should
any brochures or booklets that offer solid, supportive advice for your insured
or the surviving family members, particularly a spouse. Many of these are
available from your company or commercial publishers. The subjects
covered are typically about the importance of wills, community property
arrangements (where applicable), and other more personal advice such as
budgeting.

Generally a claims kit will also include some form of record-keeping
booklet in which the insured can list important information that the surviving
spouse will need. The names and phone numbers of financial and legal
advisors, policy numbers, amounts, company information, location of life
insurance policies, information on employee benefits, and veterans and
Social Security eligibility and benefit information could be listed. Two
copies of this booklet should be prepared, one for the surviving spouse and
one for the client’s attorney.

As in all aspects of your business, service during the death claims
process is crucial. Your words, actions, and especially the financial
assistance you can offer are important to the deceased’s survivors and to you
and your business. You will see first-hand what life insurance and other great
financial products can do for the families you serve.
**How to File a Life Insurance Claim**

**Life Insurance Benefits**
1. Contact your agent as soon as possible. He or she is qualified to advise you regarding any benefits to which you may be entitled, and will also help you secure necessary claim forms.
2. If you are unable to contact your agent, notify the nearest office of the insurance company. Be sure to provide the date of death and the policy number(s). If there is no local office, contact the home office of each company, using the address that appears on each policy.
3. Your policies may provide various methods by which the company will distribute the death benefit to beneficiaries. Ask for an explanation of the available settlement options so you can select a payment plan to fit your income needs. You may wish to obtain counsel from your agent, attorney, or other financial advisor.

**Social Security Benefits**
Apply immediately for any benefits at the nearest Social Security field office. A delay in filing your claim may result in a loss of benefits. You will need the following papers:

1. insured’s Social Security card
2. insured’s military discharge, if any
3. marriage certificate (if applicable)
4. birth certificate of each child who is under 16, or under 19 if a full-time secondary student, or who is severely handicapped before age 22
5. federal tax W-2 forms for year of death

**Veterans Benefits**
Apply for the following benefits at the Veterans Administration Field Office nearest you:

1. National Service or U.S. Government Life Insurance. You will need:
   a. a certified copy of the death certificate
   b. a certified copy of your birth certificate (if you request a life income option)
   c. Form VB 26-4125, obtainable from the Veterans Administration
2. Burial Benefit. You will need:
   a. a certified copy of the death certificate
   b. a certified copy of the military discharge
   c. statement from the coroner showing the amount of itemized funeral expenses and by whom paid
   d. Veterans Administration Form 21-530
3. Spouse’s and Children’s Pension and Compensation. The spouse or children of deceased veterans may be entitled to certain income benefits. Your life insurance agent or the Veterans Administration can help you determine if you have a valid claim. If you or your children are eligible, you will need:
   a. a certified copy of the death certificate (include certified death certificate of prior spouse(s), if any)
   b. a certified copy of marriage certificate (include certified divorce decree of any prior spouse)
   c. a certified copy of your birth certificate
   d. a certified copy of each child’s birth certificate
   e. a certified copy of military discharge
   f. Veterans Administration Form VB 21-534
4. Compensation for Dependent Parents. You will need:
   a. a certified copy of the death certificate
   b. a certified copy of the birth certificate of the deceased veteran showing the names of both parents
   c. Veterans Administration Form 21-535

If you are filing claims for more than one veteran’s benefit, it is not necessary that you provide more than one copy of any form.
Dealing with the Beneficiary

When a life insurance beneficiary is considering the most appropriate payout option, there are some considerations that do not appear in other situations. Keep in mind that you are dealing with a beneficiary rather than an insured. Once the life insurance proceeds have been paid to a beneficiary, that money is the sole property of the beneficiary. Both the insurance company and the policyowner lose control over the policy proceeds after they have been distributed.

Avoid Emotional Decisions. The loss of a loved one makes decisions emotionally charged, and immediate concerns may seem unrealistically more important than long-term needs. You must be careful to advise your clients properly, and may suggest leaving the proceeds with the insurance company at interest—for six months or longer. Later, when life has calmed down for the survivors, and they have adjusted to the loss, you may suggest steps that will assure they reach their long-term objectives using the proceeds of the life insurance.

Other options, even for the short-term situation, may be useful. You might consider certificates of deposit, money market certificates, NOW accounts, or even regular passbook savings, if they yield more than what the insurer pays.

Often, survivors recall instructions or suggestions from the deceased, perhaps in a letter that states how the deceased thought the money might be used. If the advice or wishes are outdated and there are other, better ways to apply the policy proceeds, your client may have a difficult time deciding to deviate from those wishes. As you counsel your clients, consider these and any other pertinent aspects of each situation. Do not be hesitant to suggest waiting or bringing other experts into counsel.

Considerations. With any investment opportunity, beneficiaries need to weigh their objectives against such factors as safety of principal, rate of return, liquidity, and ease of management. Our purpose in looking at the several payout options is to learn how they might help beneficiaries meet their different financial objectives.

When you help the beneficiaries select their most appropriate payout options, you build a reputation as an adept financial-services professional who stays with your clients throughout the entire process of identifying and satisfying their financial needs.
CASE HISTORY: GREATEST ASSET

Adviser. Tony Spadetti has been in the life insurance business for more than 12 years, the last two years as a general advisor. An LUTC graduate and CLU, Tony is married and has four children. The agency’s marketplace is a large industrial area.

Prospect. Before I called the prospect, 37-year-old Mary, I knew very little about her. The lead came from the agency’s file of orphan policyholders. Many years ago, her father had purchased a $25,000 policy for her, but the father, recently deceased, was still carried as the owner.

Some checking in the city directory revealed that Mary was now the owner of a small industrial equipment manufacturing business started by her father. In the course of my first interview, I found that she was divorced and has five children, the youngest one year old and the eldest 14. None of the children was insured through our agency.

Approach. I phoned and introduced myself:

“I am calling in connection with the policy you hold with our company. I plan to be near your office on business tomorrow morning, and I would like to stop by to meet you. I would be glad to bring you up to date on some recent changes in the tax laws and in Social Security to see how they might affect your life insurance. Will you be free at 10:30, or would 11:00 suit you better?”

She replied that she had no desire at all to talk to me about life insurance but would permit me five minutes of her time the next morning, just to make her acquaintance. I could hear the noise of heavy machinery in the background.

Initial Meeting. As soon as I entered her office, she removed her watch and placed it on her desk, stating that she would give me five minutes and no more. Then she opened a desk drawer and produced a large number of life insurance proposals. Tossing them across the desk to me, she said, “These are souvenirs from the last dozen insurance salespeople. If you’ve got any intention of showing me proposals or drawing any fancy charts, don’t waste my time. I’ve seen them all.”

She concluded her greeting by telling me she had not the slightest interest in any “fancy business insurance plans,” and frankly didn’t believe life insurance was of any value to her, although she very generously conceded that for “the average working person,” it is probably necessary. She
was obviously proud of her station in life, probably due to her running the plant and a home with children at the same time. She was accomplished at an early age.

She was on the defensive. It was easy to see that any routine presentation would be useless. Many had tried before and failed. While she talked, I decided on an approach I hoped would be completely new to her. Life insurance would not be mentioned. First, there was the difficult task of gaining her confidence.

My one way to capture her attention was my knowledge of her policy. She was the insured, but not the owner. Wouldn’t she prefer to transfer ownership of this property to herself? Yes, she would. In fact, she was very interested because her father had died without a will and the policy was now in his estate. I told her I would come back at a later time with the necessary forms if she would obtain a letter of administration to make the change of ownership. She promised to do this.

On her office wall was the picture of a man I assumed to be the father and founder of the company. Having confirmed my guess, I seized the opportunity to ask how long her father had been in the manufacturing business and how the company had developed so rapidly.

Mary was eager to talk about her father’s success. For the next 15 minutes, she spoke fondly of the progress the firm had made under her father’s leadership, expressing a great deal of respect for her father and revealing a deep emotional disturbance over his recent death. It was an interesting discussion, and the time we spent talking about her father helped in establishing confidence and friendship. I listened attentively.

I had to remind her of the original time limit. She laughed and thanked me for being courteous enough to listen to her. In return, she said she would listen to any idea I might have, but she hastily added that she would buy no more life insurance.

Establishing the Need. I spoke about human life values. I explained that she is an asset to herself, her family, and her business. I made reference to a formula that she could use to assess her value as an asset in actual dollar figures. This aroused her interest and she challenged me to prove it, indicating doubt that her worth could be measured.

As I worked out the formula, I explained that because she was then 37, she had 28 years of earning power before she would reach 65. Her current earnings were $75,000 a year and it would be reasonable to expect no reduction in this. Multiplying that by 28 showed $2.1 million of anticipated future earnings. Then I included her own costs for maintenance and taxes, cutting the figure by 50 percent to yield the total value to her family and business to be at least $1 million. Even at conservative rates, an investment of her value would yield over $80,000 per year.
Comparing this “asset” to other assets, such as her home, the manufacturing plant, and the heavy machinery, I pointed out that she should not leave these other valuable physical assets unprotected. Yet the most precious asset she owned—her income-producing ability—was grossly neglected and sadly uninsured.

I stressed that when she was gone there was no guarantee that someone could continue her business. It might have to be liquidated. Because the value of the company was now largely due to her skill and knowledge as its leader, there would be a tremendous loss.

During the discussion she had become absorbed with the analysis of her position. Now she asked how much $100,000 of new life insurance would cost. Here again was a key point in the interview. The great temptation was to quote a rate and try for the easy sale.

I controlled my first impulse. I replied that I would not think of insulting her by suggesting she buy $100,000. This would be like proposing that she insure only the windows in her factory. A person in her position—an investment worth over $1 million—should never be insured for anything less than $250,000, and even that might be low considering her personal situation with the children and the business.

This startled her, but I could see the idea beginning to take hold. Telling her that permanent coverage was probably the best recommendation in her case, I suggested we review the figures on $250,000. As I explained the estate, or creative values, and the accumulation of contingency funds as living benefits, I emphasized that this was not just a sheet of paper with unintelligible legal clauses. Life insurance was property in every sense of the word. I completed my presentation by showing her the income power of the annuity feature, and painting a rosy picture of retirement for her.

*Close.* It was time again for restraint. Up to this point she had listened attentively, but had been unresponsive to any leading questions. I decided to keep quiet. We sat in silence for a long time. To me it was like two hours. It was a nerve-wracking struggle not to speak, but I was successful.

“How much does this cost?”

Again I resisted the impulse to name a figure. I replied that I couldn’t answer yet because it depended on her qualifications, but she could be assured it would be a fair premium based on her health and other considerations. The first step to securing an answer involved a thorough medical examination. Unless she could meet the company’s rigid standards, she could not have the insurance, no matter how much she might be prepared to spend. Was there any reason for thinking she might not qualify?

As a matter of fact, there was. Since birth she had had a heart murmur. Several doctors had advised her that it was not a serious defect and was nothing she should worry about. Because she had already been insured at
standard rates, I did not believe she would fail. But I emphasized the potential problem to impress her with the need to be examined.

After much hedging, during which she repeatedly asked the cost, she agreed to be examined for $150,000. She even agreed that if the premium was fair (standard), she might consider the additional $100,000. Feeling that I had obtained the advantage, I began to fill in the application that I had put on her desk under the policy data card at the beginning of the interview.

After arranging the examination, I made several attempts to get a binder, but she refused. She said she would pay only after the goods were delivered to her satisfaction. I settled for her promise that she would pay for at least the $150,000 if the company issued it.

When I submitted her application, I ordered two policies, one for $100,000, the other for $150,000. The investigation was lengthy; a second medical was requested. At last the contracts were issued, but rated. Although the rating was moderate, I knew the toughest part of the sale was still ahead.

**Delivery**—I arranged an appointment to review the policy. Mary was very upset about the rating. Although she had no idea about the difference in premium between standard and a special class, she was irate that she had not been offered the lowest price. After a long discussion about the company being impartial, and that it must charge as it does for all the compelling reasons, she told me she felt the company had not been fair. She did not intend to accept the policy.

I reminded her of our agreement that she would buy the basic $150,000, which she obviously needed. At the same time, I attempted to show that she was fortunate because if the company had not felt she was a good risk, she would not have been granted the option to secure the additional $100,000. Many times a company will make an offer in the interest of harmony and service, but if the client once refuses, there may not be a second chance at such favorable rates. She could even be turned down, completely.

I asked if the children would feel that the company had been unfair if she were killed in an accident that night. She did not answer right away, but maintained a thoughtful silence.

**Final Crisis.** After a moment, she spoke. She said she had a suggestion. In her business, she explained, it is common for the company to lower its price or the salesperson to cut commissions when negotiations bog down. She liked me, she went on, and would be glad to have me as her insurance adviser. Her offer was that if I “made her a deal” we could “do business.”

I was purposely silent for a moment. When I spoke I chose my words very carefully. This prospect could not be expected to know the ethics and rules of my business. The suggestion had to be turned down flatly, but there was no call for offending her because she had naturally assumed that what is all right in one sales situation is all right in another.
I said that I had never and would not now “make a deal,” for three reasons. First, life insurance is not a commodity that can be bartered. It is a contractual property and professional service. As such, it is governed (just as medicine and law are) by a code of ethics, and that code forbids any life insurance advisor to make deals for service. Second, proper conduct of the life insurance business is governed by state statutes that, among other things, make price cutting an offense for which both parties are punishable by law. Third, the compensation I earn for my services is fair. I would feel I was cheating myself if I gave them for less than their just worth.

I won’t tell you about the debate that followed for almost half an hour. Suffice it to say that she grudgingly (as she put it) admired my stand in the face of possibly losing the sale. She bought the entire $250,000, arranging to pay the premiums through the business, because she needed the protection.

**Comment.** There were many lessons in this sale. I made the sale because I conducted myself as a professional life underwriter through knowledge and sales skill, thorough preparation, careful analysis of the prospect, and flexibility in the selling interview. It means I was an advisor and a salesperson, not an order-taker, and it means I stood by principles of integrity in a difficult situation.

My client respected me for being a professional. Since then she has purchased $75,000 more from me, and we are in the process of reviewing her program for a third time because she is presently reorganizing her business. She has also referred me to a number of her competitors and suppliers who are now among my best policyowners.

**CHAPTER EIGHT REVIEW**

*Key terms and concepts are explained in the Glossary. Answers to the review and self-test questions are found in the back of the textbook in the Answers to Questions section.*

**Key Terms and Concepts**

- old-age adult market segment
- young-old
- old-old
- estate planning
- operation of law
- right of contract
- will
- intestate
- testator
- federal estate tax
- taxable estate
- marital deduction
- charitable deduction
- state death and inheritance taxes
- applicable credit amount
- incidents of ownership
- gift tax
- annual gift tax exclusion

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probate
trust
revocable living trust
pour-over will
power of attorney
advance directives
living will
health care proxy
annuity
immediate annuity
defered annuity
fixed annuity
variable annuity
supplementary contract
settlement options

Review Questions

8-1. What are the common characteristics of the old-age market segment?
8-2. What are the common needs of the old-age market segment?
8-3. Explain how seminars can be used to approach senior prospects.
8-4. List and explain four ways property may pass at death.
8-5. Explain what happens if a person dies without a will.
8-6. What are some of the requirements of a will?
8-7. Define the following items:
   • applicable credit amount
   • marital deduction
   • three-year rule
8-8. Explain the uses of life insurance in estate planning.
8-9. Name three federal tax benefits that can occur as a result of making charitable gifts.
8-10. Explain some of the advantages your clients will realize by using life insurance as the vehicle of gifting.
8-11. Explain the concepts and methods of distribution planning.
Self-test Questions

Instructions: Read Chapter 8 and then answer the following questions to test your knowledge. There are 10 questions. Choose one answer for each question, and then check your answers with the answer key in the back of the textbook.

8-1. Which of the following statements concerning the federal gift tax is correct?

(A) Federal gift taxes are paid by the recipient of the gift.
(B) Any person can give an amount up to the annual gift tax exclusion to any other person with no federal gift tax imposed.
(C) Federal gift tax rules are unrelated to the federal estate tax rules.
(D) Any person may make unlimited gifts to any other individual without federal gift taxes being imposed.

8-2. John, age 62, was the beneficiary of a $100,000 life insurance policy on his father who recently died. John chose a settlement option which guarantees him $550 per month for the rest of his life. Upon his death, all payments will cease. This settlement is a

(A) life income
(B) life income with refund
(C) fixed period income
(D) specified amount

8-3. Which of the following statements about how property transfers at death is correct?

(A) If a person has no will, the property will always go to a spouse, or nearest kin.
(B) Property will pass by contract, only if there is no will in effect.
(C) Advisors should recommend that clients have a valid will or other arrangement to ensure an orderly disposition of assets upon death.
(D) The provisions of a will take precedence over beneficiary designations.
8-4. Which of the following statements concerning seminars for seniors is (are) correct?

I. Financing healthcare, increasing retirement income, and reducing taxes are good seminar topics for seniors.
II. It is important to maintain the purpose of the seminar, which is to impart information.

(A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II

8-5. Which of the following statements about advance directives is (are) correct?

I. A living will lets others know your medical wishes when you are terminally ill and/or unable to communicate.
II. A healthcare proxy is effective even in cases where the patient is able to communicate his or her healthcare decisions.

(A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II

8-6. Which of the following statements concerning estate planning is (are) correct?

I. Estate planning encompasses the accumulation, conservation, and distribution of an estate.
II. The major objective of estate planning should be to minimize estate taxes.

(A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II
8-7. Which of the following statements regarding a will is (are) correct?

I. If an individual dies without a will, all states allow the property to be divided equally among his or her remaining relatives.
II. The laws of intestacy, which vary by state, determine how a deceased person’s property will pass if he or she died without a valid will.

(A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II

8-8. Which of the following statements concerning a revocable living trust is (are) correct

I. One advantage of a revocable living trust is that assets in the trust avoid probate upon the trust owner’s death.
II. Assets within a revocable living trust are protected against Medicaid spend-down requirements if the owner requires care in a nursing home.

(A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II

8-9. All of the following statements about aging in America are correct EXCEPT

(A) Aging is a highly individual experience, affecting different people in different ways.
(B) Social gerontologists distinguish between the “young-old” and “old-old” segments of our aging population.
(C) You can safely assume that most clients over 60 cannot learn new material.
(D) For some older people, advisors may need to repeat information or speak louder to them.
8-10. When a person dies, his or her property will normally pass to heirs in all of the following ways EXCEPT

(A) by a lottery system among eligible heirs
(B) by operation of law, such as jointly-held property
(C) by right of contract, such as with life insurance beneficiaries
(D) by a will or trust arrangement