INSURANCE

The Importance of a Mid-Career Financial Checkup

by Peter Klein

The rise in entitlement costs means significant changes to retirement planning.

OUR EARTH SITS AT the outer edge of our galaxy and, as the galaxy rotates in space, earth is being inexorably propelled into a colder, darker area of space. Although the cosmos is always changing, astrophysics allows us to predict the movement of objects in space.

Change is also a factor for residents on the surface of the earth, bur predicting human outcomes is problematic. Humans sometimes behave in unpredictable ways, and there's always the law of unintended consequences. We have an inherent blind spot to discerning change and, even if we are able to foresee changes, our reaction to change can vary widely. Often it boils down to doing nothing. In the next several years, we will witness significant changes, given the Federal Government's new initiatives in healthcare, chronic Federal deficits and looming national debt. Retirement planning doesn't happen by itself, and the results are often impacted by outside forces; yet most people are heading towards retirement on autopilot. It's critical for an individual to address retirement in mid- career, and from time to time make mid-course correctors.

CHANGES IN HEALTHCARE

The U.S. healthcare system is a behemoth that accounts for 18 percent of gross domestic product (GDP) and employs about 1.5 million people, of which 850,000 are licensed physicians.

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The 2010 Affordable Care Act requires expansion of healthcare to include an estimated 45 million uninsured and an additional 8 to 12 million undeclared aliens with the granting of residence status. This will take effect at a time when the U.S. has 15,230 fewer primary-care doctors than it needs, according to the Department of Health and Human Services. The Association of American Medical Colleges predicts the shortage will climb to 130,000 by 2025. What's even more alarming is that the Government has done nothing to prepare by either expanding healthcare infrastructure or developing additional medical staff, while proposed cuts in Medicare reimbursement have had the opposite effect causing hospitals and clinics to cut overhead and staff. The LA Times recently published that California lacks doctors to meet demands of the national healthcare law, and so are redefining roles of existing medical staff. For example, pharmacists are now running a hospital's diabetes clinic, caring for 500 patients, since the specialist physician in charge retired.

GOVERNMENT SPENDING TRENDS

The Federal Government is currently running trillion-dollar annual deficits. Such spending is un- sustainable, given the country's national debt approaching $17 trillion. In four years, the national debt will likely be $22 trillion . Current GDP is $15 trillion and projected to grow 2 percent annually. GDP growth will likely be outstripped by the velocity of the buildup in national debt due to deficits and growth in entitlements . Major elements of entitlement programs are Social Security, Medicare and Medicaid. Unfunded entitlement cost estimates range from $85 to $110 trillion.

The fatal flaw in proposed entitlements is the skyrocketing dependency ratio. The number of young people entering the workforce is not growing fast enough to support the exploding population of nonworking, aged 60 through 90. Meanwhile, elderly over consumption of healthcare services threatens to bankrupt the healthcare system. According to a Kaiser Foundation study, government spends $4 on every adult over 65 for every $1 spent on someone under 18.

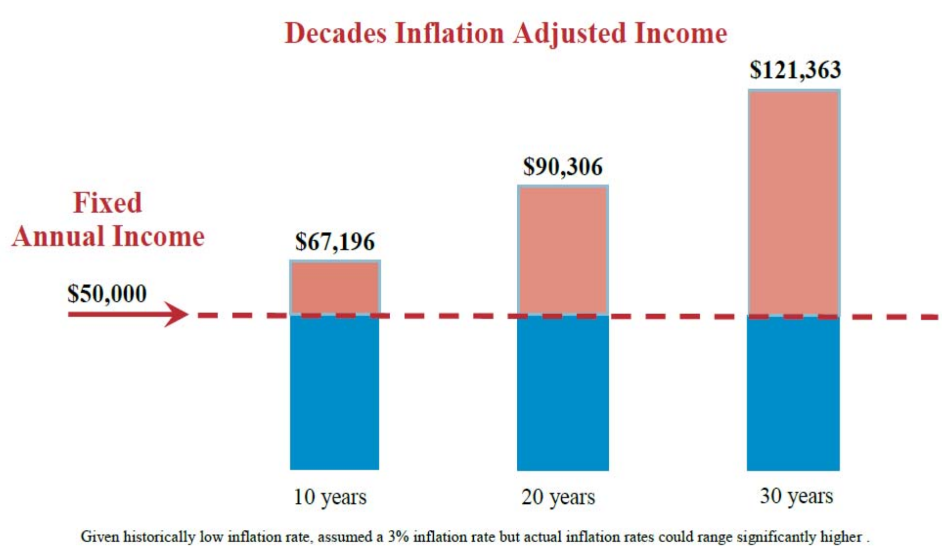
The impact to our healthcare system is fairly predictable. It could easily be overwhelmed, which could lead to rationing. Panels set up by Obama Care will decide who will get access to advanced and often expensive medical care. The presence of these panels telegraphs future rationing of healthcare and the likely shift of resources from the old to the young. Obama Care will significantly add to the cost of healthcare. Revised Congressional Budget Office (CBO) estimates projected costs to be $1.76 trillion over a decade versus their initial $940 billion estimate when the healthcare legislation was signed into law. Rationing healthcare to the elderly will likely lead to greater reliance on out-of-pocket private medical care.

Given the aging of baby boomers, elderly over consumption of healthcare services and the unprecedented expansion of healthcare, the overwhelming conclusion has to be that entitlement expenditures will have to be controlled by dramatically raising eligibility ages, financial means testing and rationing of healthcare. This will likely impact the cost structure of retirees disproportionately. Fidelity's study of health costs estimates that a typical couple retiring at 65 would need about $240,000 in today's dollars to cover their health costs, and this assumes entitlement programs such as Medicare continue to be funded at historical levels.

INFLATION RISKS

Inflation may be historically low today, relative to the late '70s and '80s, but as the economy picks up steam again, inflationary forces could become a factor. The cost of basic necessities-food, housing, utilities —will likely rise. Grain prices are at record levels. The price of corn has almost tripled since the '80s. Typically, wages rise as consumer prices increase, so normally inflation is not a concern, but that all changes in retirement. Most people underestimate the impact chat inflation will have on their income in retirement.

The following chart demonstrates the amount of money you'll need to counter the effects of even modest inflation over rime, while over the last 40 years inflation has been as high as 10 percent annually. For many retirees on fixed incomes, inflation can make even basic necessities seem like luxuries, forcing some retirees to choose between paying utility bills or responding to their healthcare needs. While Social Security and some pension programs do adjust income for inflation, retirement savings are greatly devalued by inflation.



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PREVIOUS GENERATION'S FINANCIAL FACTORS

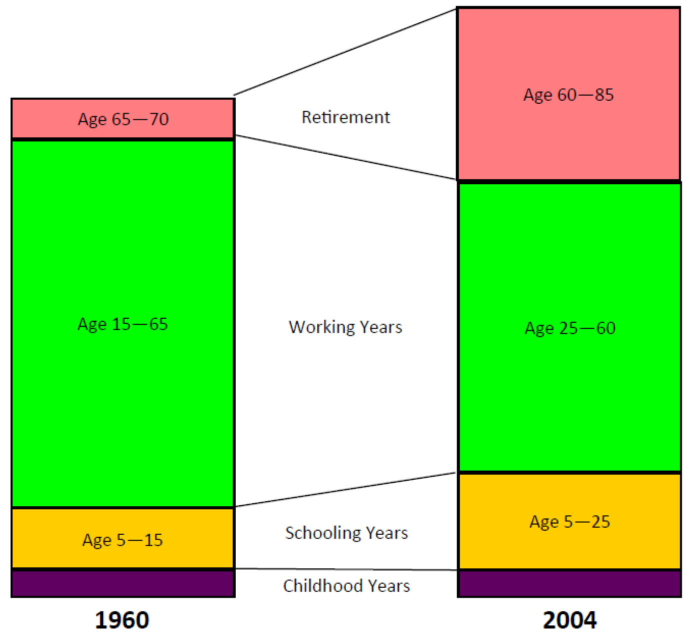
The previous generation born in the 1930s enjoyed a relative cornucopia of advantages compared to succeeding generations:

- **An era of lifetime employment.** Based on an implied contract. If you did your job and remained loyal to the organization, you had a job for life.
- **Predictable peak earning years into 50s.** As a consequence of staying with an employer, employees were rewarded with consistently rising wages that typically peaked into their - 50s.
- **Greater opportunity to increase savings rate in their 50s.** This was based on the assumption that kids would be out of the house, significantly lowering utility, energy and communications expenses, and a steady rise in home values with huge mortgage expansion by Government Sponsored Entities (GSEs), Fannie Mae and Freddie Mac.
- **Access to a wide range of debt financing.** mortgage options, credit card, lines of credit, auto financing. Numerous federal programs were designed to expand home ownership, including significantly reduced down payment requirements, access to subprime mortgages for people with poor credit racings and reverse mortgages for retirees.
- **Reliable company pension.** Prior to 1990, defined benefit plans outnumbered defined contribution plans .
- **The previous generation inherited a tsunami of entitlements and benefits, including.** Social Security for those 62 and older, including a cost-of-living adjustment; Social Security Disability Insurance became law in July 1956; Social Security Amendments of 1965 resulted in the creation of Medicare and Medicaid, which provided federal health insurance for the elderly (over 65); and Medicare Part D, the Medicare prescription drug benefit program subsidized the cost of prescription drugs for Medicare beneficiaries.

DEMOGRAPHICS ARE OUR DESTINY

Unlike the unpredictability of federal spending or healthcare cost increases, demographic trends are as predictable as the rotation of our solar system. A nation's demographics are its destiny, which can best be illustrated by the following statistics: In 1900, 1 in 24 Americans was over the age of 65. In just 18 years, it will be 1 in 5. We will be a nation that looks like the state of Florida's demographics today. In 1960 there were five working Americans for every retiree. By 2025, in just 12 years, there will be just two workers for every retiree. Historically, Medicare, Medicaid and children's health care made up less than 15 percent of federal spending. Today, they are in excess of 22 percent of spending. Based on demographics alone, these entitlement programs are at unsustainable levels.

Graphic Illustration of Next Generation's Retirement Challenges



THIS GENERATION'S REALITY

For this generation in their 50s, the era of lifetime employment is over while this country's ability to fund deficit entitlements is unsustainable; so the realities are dramatically different. Today's 50- year-olds will likely be confronting significant challenges:

- **The lost decade.** The dot com bubble in 2001 followed by the onset of the grand recession in the fall of 2008 has resulted in a lost decade of savings and investment return.
- **Significantly longer life spans**. The average person can expect to live on average decade longer in retirement than just the previous generation.
- **Fifty-year-olds have experienced disproportionate volatility in their careers**. Baby boomers in their 50s may not enjoy top wages after all. The era of implied lifetime employment is gone. In an economy dominated by high technology, employment opportunities diminish as we age and become less reliable when reaching 50. Established industries have been buffeted by an economy dominated by high-tech companies and by competitors systemic arbitraging of cheaper overseas labor.
- **Defined benefit plans (pensions) have largely been displaced by defined contribution plans, resulting in the offloading of retirement planning and responsibility entirely on the individual.** This will be the first generation of retirees who are mostly dependent on nontraditional pension incomes, instead relying on defined contribution plans such as 401 (k)s, IRAs, annuities and universal life investments.

In one generation, the outlook of future retirees has undergone

Unlike the unpredictability of federal spending or healthcare cost increases, demographic trends are as predictable as the rotation of our solar system.

LIMITATIONS IN ADDRESSING THEIR RETIREMENT NEEDS

In general, people are hardwired to see the world as it was, not as what it is transforming into, often in subtle and accretive ways. People have behavioral predilections chat get in the way of comprehending the changes taking place as the cycle of progress and obsolescence accelerates. For example, industries have undergone enormous changes. In the 1980s, General Motors and Kodak were long-established firms that were leaders in their respective industries. Today, one of those firms has gone through bankruptcy while the other is a shadow of its former self. Alternatively, major companies such as Google, Amazon and Facebook didn't even exist at that time.

The wholesale shift from defined benefits to defined contribution plans places the entire burden of retirement planning and management of retirement funds on to the individual. Given the shift of retirement to the individual who typically doesn't have the necessary .financial skills, .financial professionals can play a significant role in providing the insights and skill sets needed to define a retirement plan.

WHY RETIREMENT COSTS WILL BE SUBSTANTIALLY MORE THAN ANTICIPATED

If you were born in 1950 and are educated and relatively successful, you will likely live 20 years longer than someone born in 1930 when it was fashionable to smoke and medical technology was limited. Access to healthcare that offers timely and advanced medical care can have a substantial impact on lifespan.

The influx of uninsured and our-of-control spending on healthcare will likely cause a bifurcation of the healthcare system. It could evolve into a public healthcare system providing basic care with private medical care offering advanced, timely medical care for cash. We already have a model of this in Germany and Canada, which offer free public healthcare characterized by crowded waiting rooms and controlled access to doctors, with advanced medicine rationed. (Given these limitations, Canadians routinely exercise their option to come to the U.S. for advanced, timely treatment.)

As deficits clash with ever looming national debt levels, the U.S. labor force will likely be split into two distinct cohorts: those who are 55 and older who will still be entitled to existing benefits and those who are under 55, who could experience substantial curbs in entitlement benefits, forcing the next generation of retirees to bear a greater share of healthcare costs. Consequently, those under 55 will likely place a greater reliance on private medicine and incur a higher cost of retirement .

Money is of vital importance to successful aging. It allows older people to maintain their self-respect and independence. As one ages and becomes disabled or frail, money can be the difference to maintaining autonomy or an independence that is restrained with lower living standards. State or charitable services are designed so that the client fits the service rather than as an aid to client autonomy. To retain autonomy, you have to assess future retirement finances before retirement takes you by surprise.

CLIENT RETIREMENT CHALLENGES AND SOLUTIONS

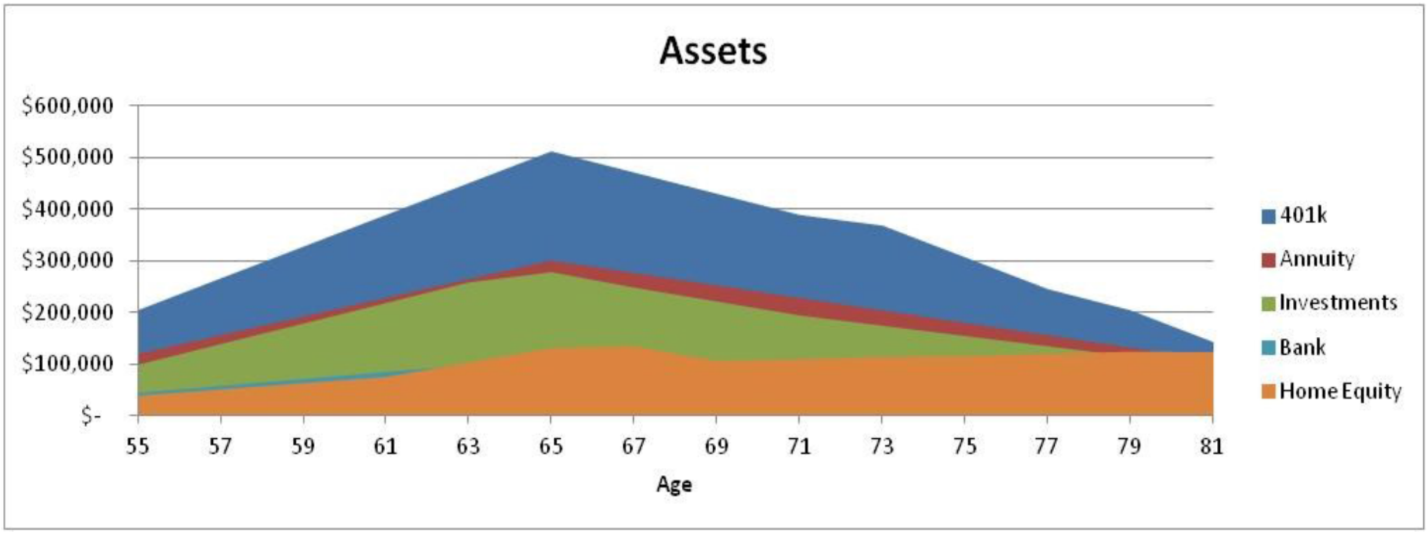
Given the complexities of planning for retirement and the inherent trap of underestimating retirement costs, it's paramount for a client to undergo a mid-career financial checkup by a financial professional. The challenges Americans face to achieve a comfortable retirement are substantial, and are likely to be impacted by unanticipated events such as those highlighted in this article. The problem is exacerbated by the continued replacement of benefits such as pensions and prospective Social Security benefit cuts of those who are under 55.

Conventional investments are taxed whenever they pay out earnings and again on profits when you sell. Taxation can reduce the long-term earning power of your investments, but tax-advantaged accounts such as a 40 I (k), IRA and annuities are specifically designed for long-term retirement planning, deferring taxes in exchange for restrictions on early withdrawals. Retirement plans and IRAs have contribution limits, while individual annuities are generally not limited in the amount you can contribute each year.

One option is to offload the risk of capital markets and living too long. Life insurance carriers are regulated by the scares and must maintain reserves to meet future beneficiary obligations. Their capitalization structure gives preference co beneficiaries if there are inadequate assets. In the case of fixed and indexed annuities, they offer guarantees that their future balances will be at or above the amount invested. Effectively, clients have a guarantee chat they will receive back at least as much money as they invested in the annuity while annuities offer the added benefit of tax-efficient, tax-deferred returns.

A relatively new innovation is a simple deferred annuity modified to provide insurance against outliving your savings. Several insurance companies offer such an annuity that is purchased before retirement but doesn't payout until age 80 or 85. For example, a 65-year-old male can purchase an annuity for $18,500 to provide $1,000 a month guaranteed

Distribution of Asset Holdings for Typical Work to Retire Transition Client



beginning age 85. The downside is that if the beneficiary dies before 85 the entire investment is lost.

Some retirement planners recommend that clients reserve at least 40 percent of their retirement assets for unforeseen circumstances. Because most annuities are designed to provide steady income over time, they are not suited to cover large unplanned expenses. There are many types of annuities, and choosing the right one can be overwhelming. As fixed annuities are considered safe and conservative investments, they don't offer the returns of riskier investments. In addition, annuities are typically less flexible than other retirement options because annuity contracts tie up capital.

Another alternative is a hybrid life insurance policy with a long-term care rider. The policy offers the flexibility of a death benefit in the event of an untimely death, but also offers a long-term care benefit that can be accessed without the normal limitation of meeting two of the six activities of daily living requirements; rather it empowers the primary physician to determine accessibility.

RETIREMENT PLANNING GOING FORWARD

Retirement planning these days, like many things in life, is harder than it seems. There are many variables such as longevity, interest rates, market volatility, health care costs, potential changes in access to advanced medical care and need for autonomy. Fifty-year-olds today have the added challenge of the lost decade of investment returns with the recession of 2008, a decade in which the stock market and the real estate crisis wiped out much of their home equity right in the middle of their retirement saving years. The key now is to avoid mistakes that could make life difficult later.

To quote writer Somerset Maugham, "It's not wealth one asks for, but just enough to preserve one's dignity, to live unhampered, to be generous and independent."

Mr. Klein has over 25 years of experience as a financial advisor, banking and management consultant. His experience encompasses both life insurance products. along with their applications.

He has been in the forefront of developing unique financial planning tools, including the utilization of actuarial tables in the development of customized biometric mortality curves that can be used by high net-worth clients to better understand their financial needs and to empower them to validate financial advice.

Mr. Klein has built his life insurance sales practice by servicing financial professional firms and their clients. The unique client centric comparative longevity planning report, that utilizes proprietary longevity tables, has given financial professional renewed impetus in building their client base.

Mr. Klein has two graduate degrees, an M.S. in Science and Pathology, an MBA from the University of Connecticut. He is also a Chartered Financial Analyst (CFA).

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