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Reality Check For Financial Plans

Many financial planners take a conservative approach in planning and assume that clients will live to be 105. This article points out how this has the potential to seriously disserve clients and describes a new tool available to planners that can help them build more customized and suitable plans.

The "alive-to-105" approach places great stress on investment strategy and portfolios to attain the necessary levels and to perform satisfactorily. If financial planners applied a customized longevity curve analysis for their clients, they would be in a position to develop more appropriate asset allocation strategies for their clients. The analysis offers insights that aid the planner in other ways as well, as discussed later in this article.

Using Life Expectancy Analyses in Planning

In the past year, a decade-old tool, the life expectancy analysis (LE), honed in the life settlement/viatical sphere, has come to the fore as a planning device of far wider application.

LEs were developed in order to assist the buying decisions of financial institutions that purchase life insurance policies from insureds who no longer need them.

The handful of specialized under-

writing firms that produce these analyses have developed highly specialized mortality tables, and these tables are particularly appropriate for use by financial planners who serve older, more affluent clients.

The Mortality Table compares three different mortality tables: The table at the top is the Social Security Table; the middle table is the new 2008 Valuation Basic Table (VBT) developed by the Society of Actuaries; and the table at the bottom was developed in 2008 by one of the specialized medical underwriting companies referred to above.

The differences in life expectancy from one table to another are dramatic. For example, a 70-year-old male in the Social Security Table has a life expectancy of 13 years.

Alternatively, a 70-year-old male in the 2008 VBT has a life expectancy of 18.6 years, almost 40 percent longer. Finally, the table produced by the medical underwriting firm projects an even longer life expectancy for such an individual—20.2 years.

In general, successful people—those most likely to use the services of financial planners—are more likely to exhibit the mortality characteristics expressed by the mortality tables developed by these specialized medical underwriting companies, which include promi-

nently 21st Services, AVS and Fasano. Typically, financially successful people are more likely to take a proactive approach to managing their health and have the means to safeguard it.

The Value of Life Expectancy Information

Financial professionals targeting high-net-worth individuals need to be aware of the mortality characteristics of their prospective clientele and to utilize that information in their planning. Even more to the point, they need to understand how knowing a client's specific longevity curve can improve their planning.

Mortality tables are not designed to predict the actual date of an individual's death, of course; rather, they give numbers representing the expected mortality of a large pool of individuals with similar medical and personal characteristics.

However, a customized longevity report can be developed by overlaying a client's medical history and lifestyle information on the mortality table data. The principal feature of such a report is a longevity curve which plots the client's survival chances year by year. It provides a relative illustration of an individual's mortality curve against his peer group. These curves are not meant to be viewed as predictors of an individual's death, but they do provide useful information about what is statistically likely.

Strategic and Tactical Considerations

How does such information assist professionals in advising clients? To begin with, the curve offers probabilities of living for a long time. Suitability of investments should be adapted or tailored to a client's remaining lifespan. The longer the life expectancy, the more risk may be incurred, since clients may have sufficient time to recover from marketplace corrections.

Mortality Table Comparison

Social Security Table						
Male Age	LE	Expected Age	Female Age	LE	Expected Age	Women Outliving Men in Years
55	24.0	79.0	55	27.5	82.5	3.52
65	16.3	81.3	65	20.0	85.0	3.65
70	13.0	83.0	70	15.5	85.5	2.50
75	10.0	85.0	75	12.0	87.0	2.05
80	7.4	87.4	80	9.0	89.0	1.57
85	5.3	90.3	85	6.4	91.4	1.14
2008 Valuation Basic Table						
Male Age	LE	Expected Age	Female Age	LE	Expected Age	Women Outliving Men in Years
55	31.2	86.2	55	33.3	88.3	2.08
65	22.8	87.8	65	25.0	90.0	2.25
70	18.6	88.6	70	20.7	90.7	2.09
75	14.7	89.7	75	16.4	91.4	1.75
80	10.9	90.9	80	12.5	92.5	1.58
85	7.2	92.2	85	8.6	93.6	1.41
Medical Underwriter's Table 2008						
Male Age	LE	Expected Age	Female Age	LE	Expected Age	Women Outliving Men in Years
55	34.3	89.3	55	37.7	92.7	3.33
65	24.7	89.7	65	28.3	93.3	3.66
70	20.2	90.2	70	23.9	93.9	3.75
75	16.9	91.9	75	19.4	94.4	2.49
80	13.0	93.0	80	15.3	95.3	2.33
85	9.8	94.8	85	11.8	96.8	2.08

Source: 21st Services

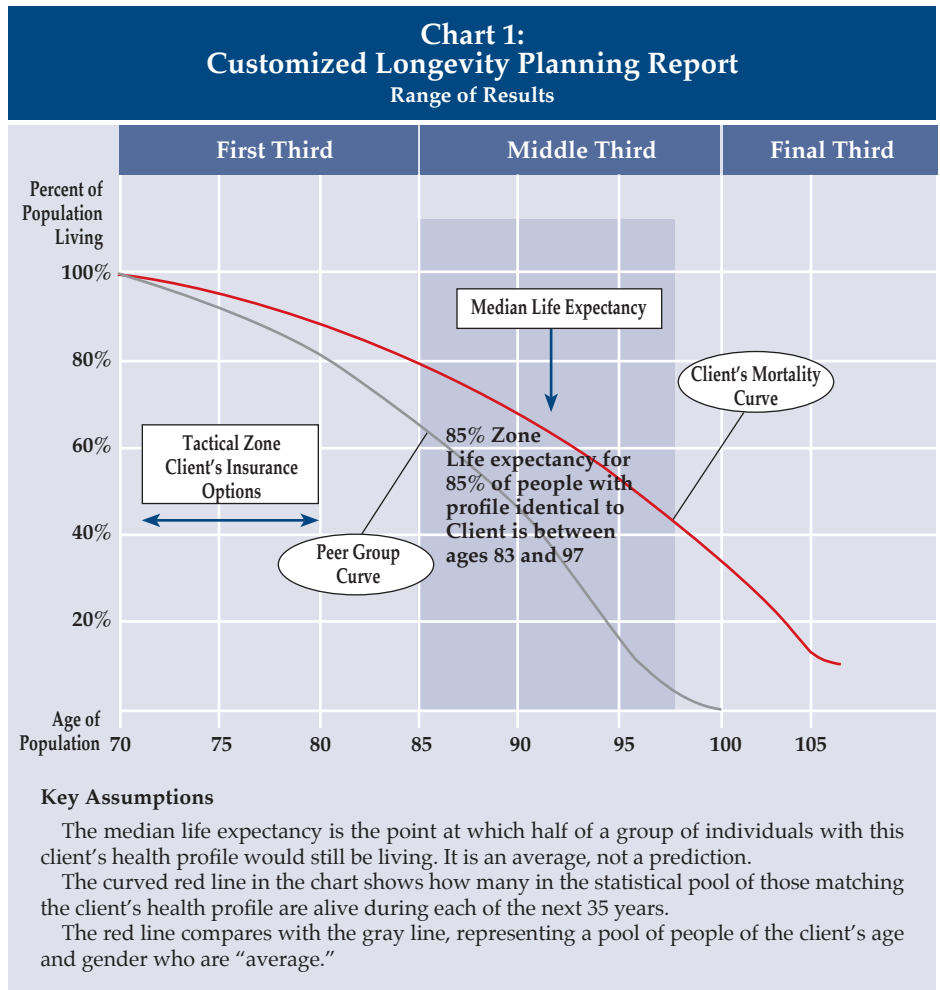
In the case of life insurance products, the client's mortality curve relative to his peer group's curve can provide arbitrage opportunities. Life insurance companies will underwrite a case based on the peer group's curve, while the client with more insight into his actual mortality curve relative to

the peer group gains an advantage.

Interpretation and Application

Chart 1—Customized Longevity Planning Report: Range of Results—is based on a graph you will find in a life expectancy report and shows two curves. The first (in red) is a typical mortality curve for someone with a long life expectancy. The y-axis of the curve represents the population still living, while the x-axis is an age scale. I have divided the curve into three stages. The first third is the period when most members of the population are still living. The middle third is the period during which 50 percent of the people with a profile identical to the client's face the probability of dying. The hypothetical client's curve is broader, or not as steep as the peer's. The midpoint of the client's curve shows a 50 percent probability of death at age 92.1—considerably higher than the peer group. The final third shows a flattening of the curve representing the client's morbidity period.

A person with this mortality profile may be advised to own a limited amount of life insurance, unless there are likely to be inheritance tax issues. In that case the client may want to own a guaranteed policy or a current assumption policy with an extension rider. Such a person is clearly at risk of outliving the policy. They could be advised to purchase an annuity because they are at risk of outliving their savings. They might also be in a position to engage in arbitrage with the insurance carrier. The carrier would be likely to underwrite this type of client based on a mortality curve much like the curve shown in the graph for the client's peer group. Such a client might also be a candidate for long term care insurance, given the length of the curve's morbidity period.

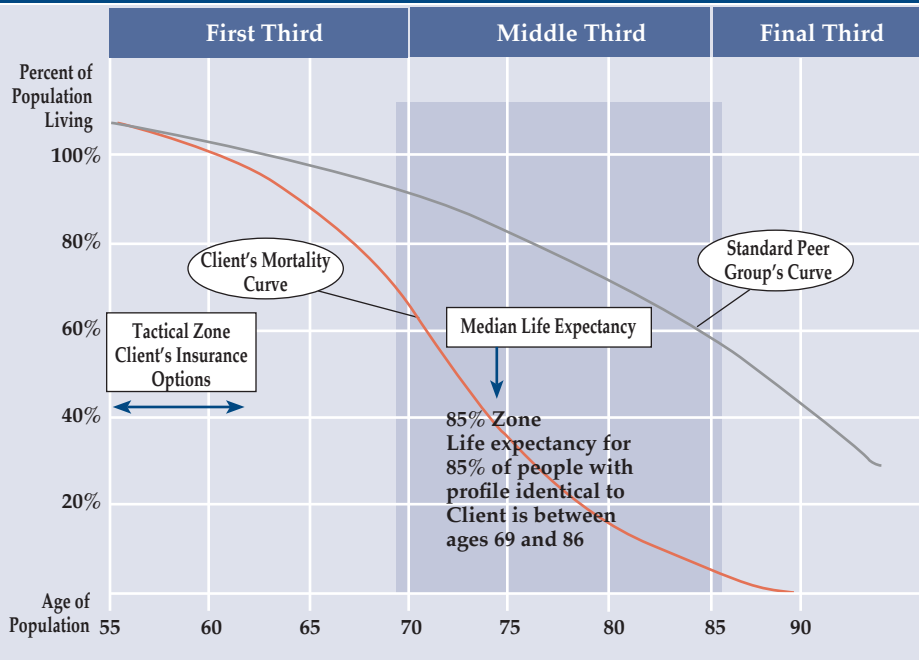


In Chart 2—Customized Longevity Planning Report: Range of Results—the red line represents the mortality curve of someone with a shorter life expectancy, in comparison to the gray line representing a pool of those of an age and gender matching the client's. In this case, the client is a male smoker. As is apparent, the client's curve is steeper than his peer group's. The client's 50 percent mortality age is 77.3 years. The final third shows a very shallow flattening of the curve; the odds are that the client's morbidity period will be relatively short.

Such a client should be advised to

consider acquiring as much life insurance as possible while he is of an age to qualify as a standard smoker; as his projected medical symptoms begin to manifest themselves, he could sell some of these policies to fund remaining policies for many years to come. Such a client should not be advised to purchase an open-ended annuity since he would be unlikely to collect as many payments as his peer group. He is at lower risk of outliving his savings. Long term care insurance may be desirable for this client, but it may be less important than for the client in the previous example.

Chart 2:
Customized Longevity Planning Report
 Range of Results

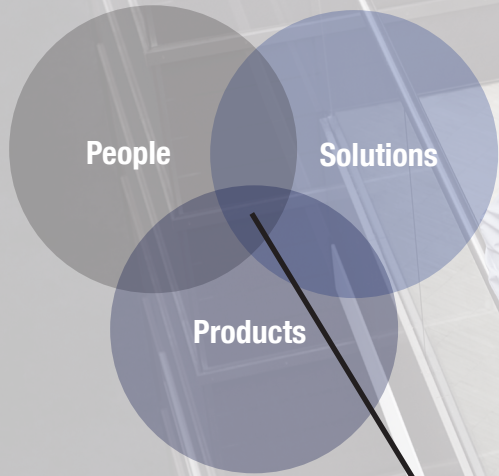


Taking a Compass Reading

At what age does this type of analysis become appropriate? It becomes critical at age 55 and above, a financial right of passage age. Just as a submarine has to surface to take a compass reading to verify course and direction, so must responsible individuals. Ten years prior to entering retirement is a good time to take inventory and evaluate one's financial plan.

A life expectancy evaluation is useful with almost any client whose net worth is \$500,000 or more. Individuals who have amassed wealth on a scale that is intergenerational need to gain greater precision in estimating their mortality risk so they can develop appropriate financial and estate plans. Those clients who have more modest savings need to know with better precision their risk of outliving their savings. 🌐

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