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Longevity Throws a Wild Card in Even the Best-Laid Plans

Jamie L. Mendelsohn

John Steinbeck's famed novel *Of Mice and Men* derives its title from a line in Scottish poet Robert Burns's "To a Mouse," written in 1786. The poem is an apology to a mother mouse who had very carefully built her nest in a field to protect her babies. Unfortunately, the farmer decided to plow that very field, thereby destroying her nest. Her plan was cast asunder due to something totally outside of her control. Burns writes, "The best laid schemes o' mice an' men gang aft agley," which roughly translates as, "The best-laid plans of mice and men often go awry." He laments that even when you have good intentions, you can destroy someone else's plans if you're not careful. This article focuses on an often overlooked wild card in senior planning—increasing longevity—and will help give financial professionals and fiduciaries insight so that no apologies are needed later because of an oversight. Senior plans may "go awry" because of increasing longevity, but with a customized life expectancy analysis, planners will be able to help their clients make mid-course adjustments to minimize potential damage.

Many Disruptive Changes Have Caused Senior Plans to Go Awry

Many senior clients have had their plans disrupted by changes totally outside of their control. It wasn't supposed to happen, but it did. Volatile stock markets, plummeting real estate values, a sustained low interest rate environment, and underperforming life insurance policies all have had a negative impact on senior planning. Story after story could be told about how this combination of disruptive events has affected the lives of seniors in their retirement years as well as those approaching retirement. Seniors who are fortunate enough to have forward-thinking advisors have been making adjustments along the way to help minimize the damage.

continued on page 2

EDITOR'S COMMENTS

May 2017

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In this issue of **Estate Planning,** we feature an intriguing article by Jamie L. Mendelsohn of the Ashar Group/Ashar SMV in Orlando, Florida. It deals with two separate but interrelated topics that just naturally go hand in hand and are of interest to all financial planners.

The first topic is planning for longevity. More specifically, doing retirement, financial, estate and life insurance time-horizon planning, not on

continued on page 2

Longevity

continued from page 1

There is another often overlooked factor that has been quietly lurking in the background which can have a serious impact on senior planning. Seniors are living longer than expected, especially wealthy seniors. Even the best-laid plan can literally fall short if the time horizon you are planning for is incorrect.

In his March 15, 2017, *Estate Planning Newsletter,* Steve Leimberg states, "I predict that planners will find many uses for professionally prepared LE (life expectancy) reports ... insight into a client's specific longevity curve can provide a planning professional with an invaluable key to figuring out what tool or technique or combination will be most appropriate and suitable for that particular client."

Many Seniors Are Outliving Their Plans

How do you create a valid plan if you don't know how long you're planning for? We are asked on a daily basis to provide and interpret an independent longevity analysis for financial professionals and fiduciaries dealing with seniors who are facing complex planning decisions. They need an accurate time horizon for their client to assure that the plan is designed to last throughout their particular client's life expectancy and not just an arbitrary estimate based on age alone.

When you consider that Americans 85 and older are the fastest growing demographic group (according to U.S Department of Health statistics), it underscores the reality that the longevity of the senior population is extending.

EDITOR'S COMMENTS (cont'd.)

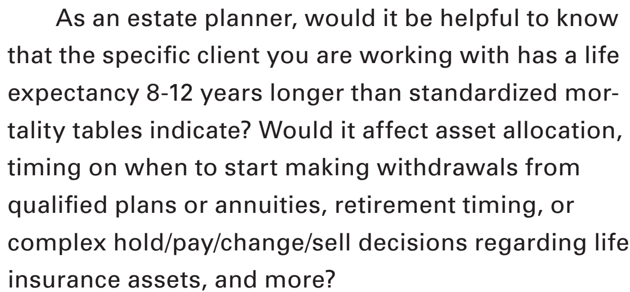
the basis of medium aggregate statistical data obtained from group mortality tables that look at the probability of dying too soon, but rather on a personalized life expectancy analysis explicitly tailored for your client.

The second topic, which is made possible by the personalized life expectancy analysis used for proper longevity planning (although longevity planning is really the byproduct), is determining the true fair market value of a life insurance policy based on the data contained in the personalized life expectancy analysis and comparable data that exists for the secondary market for life insurance, i.e., life settlements. The secondary market for life insurance has matured to the point where a true willing buyer/willing seller environment—complete with comparable data—exists to create a fair market value for life insurance as was contemplated in Revenue Ruling 59-60. This, of course, is in contrast to the one-sided exchange with an insurer on a policy's cash surrender value.

Jamie's commentary explains how outdated valuation rules may be hurting your client and discusses the advantages of market-based life insurance valuations. She also considers what happens if plans for your client get Trumped (pun intended), i.e., could tax law revisions completely change "the best laid plans of mice and men."

This refreshing article provides a fascinating perspective on topics that are relevant to all planners. Congratulations to Jamie on an outstanding analysis!

Hope you enjoy this issue of *Estate Planning.* Please share your thoughts on the Estate Planning Section eGroup. ■



As an estate planner, would it be helpful to know that the specific client you are working with has a life expectancy 8-12 years longer than standardized mortality tables indicate? Would it affect asset allocation, timing on when to start making withdrawals from qualified plans or annuities, retirement timing, or complex hold/pay/change/sell decisions regarding life insurance assets, and more?

Increasing longevity is the wild card that affects decisions being made in all areas of senior planning. The number one concern for many seniors in retirement, or approaching retirement age, is either running out of money or not having enough liquidity to sustain their lifestyle.

If you haven't adjusted the plans of senior clients to reflect their specific life expectancy, then there is a good chance that the plan will fall short, especially for wealthy clients who typically have better access to quality health care, healthy foods and nutrition, exercise programs, and fulfilling social engagements and activities. As a result, these seniors tend to have longer life expectancies than the norm. In fact, according to the Brookings Institute, males born in 1940 who are at the top 10 percent of mid-career earners can expect to have an average life expectancy 12 years longer than their counterparts at lower income levels.

Does your client's plan accurately reflect their specific time horizon? As a planner, does your liability exposure increase if you fail to factor in your client's personal life expectancy?

A Word or Two about Life Expectancy

When most people think of life expectancy, they are referring to standardized tables, such as the 2014 Society of Actuaries VBT (Valuation Basic Tables) and tables provided by various global and regional studies on life expectancy. In both cases, the tables are derived from the averaging of statistics based on a large sample group of same age individuals and give no consideration to health and lifestyle **credits**. These are of little or no value to planners who are trying to obtain a more realistic estimate of life expectancy for their senior clients.

Life insurance underwriting has long been a source of life expectancy data based on health conditions exhibited by potential insureds applying for new coverage. This type of underwriting only focuses on health and lifestyle **debits.** The life insurance issuers are concerned about clients dying too soon. Therefore, they only look at factors that would shorten life expectancy. This risk of dying too soon is called **mortality risk.**

In recent years, the regulated and institutional secondary market for life insurance has amassed a significant amount of data on potential life settlement candidates. This secondary market is led by many of the worlds' most sophisticated actuarial and longevity specialists, policy servicing analysts, asset managers, private equity, pension plans, and capital markets experts. Some of these companies continue to track the accuracy of that data by monitoring clients who have sold their policies and then fine tuning their assumptions based on actual experience.

There are some major differences between life expectancy underwriting for new insurance and life expectancy underwriting for life settlements. These differences validate why planners are better served using life expectancy analysis from the secondary market rather than insurance carrier analytics or the standard VBT or mortality tables:

1. As reviewed previously, life insurance issuers are concerned about a prospective policyowner dying too soon—mortality risk. Therefore, they focus only on health and lifestyle debits.
2. Life settlement underwriting is concerned about the client living longer than expected—l**ongevity risk**. Consequently, it not only focuses on health and lifestyle debits, but also gives major consideration to health and lifestyle credits. Recogni-

continued on page 4

Longevity

continued from page 3

tion of credits in the medical records reviewed can impact mortality as much as the debits and add several months or years to life expectancy.

Listed below are health and lifestyle factors that result in credits:

- Regular/normal build – BMI <25 (“gray” area between <25 and >35)
- Not taking any current prescription medications
- Active lifestyle
- Owning more than one home (example: vacation home in Florida, lives in New York)
- Exercising regularly—no matter the age or type of exercise
- Traveling domestically or internationally and the frequency of travel
- Family longevity
- Working—full or part-time
- Highly functioning (example: may not be working, but volunteers and completes physically and mentally stimulating activities)
- Good exercise tolerance on a cardiac stress test
- Able to perform all activities of daily living (ADLs): eating bathing, dressing, walking, etc.
- Living as a couple or alone without assistance
- Only seeing physicians annually or as needed
- Only having a primary care physician for healthcare
- Driving daily or weekly—still having a driver’s license without physician’s note stating the insured is not driving

These credits can cancel out some debits and provide a more customized picture of life expectancy. As a result, for planning purposes, health underwriting that includes a comprehensive list of both debits and credits will be a more precise reflection of your client’s personal life expectancy.

Confusion for Planners

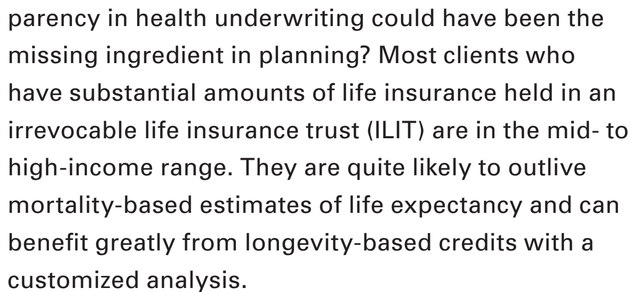
Over the past 10 years, we have seen a lack of clear understanding on the part of the planning community about the impact of lifestyle credits. You might think that if your client has been declined or has been highly rated for new life insurance, they would automatically qualify for a life settlement. Not true! You have to take into consideration credits that can minimize the impact of some of the health and lifestyle debits. These health and lifestyle credits increase a client’s potential longevity. The secondary market underwrites optimistically while taking into account the ongoing proactive management of health issues and known medical advancements and treatments.

Outdated Valuation Rules May Be Hurting Your Clients

Nowhere else is the application of credits more applicable than in determining the fair market value (FMV) of life insurance for planning purposes. To date, many planners are aware of only three values that they can use regarding life insurance: cash surrender value, death benefit, and carrier estimates of value, called interpolated terminal reserve (ITR). For gift tax purposes, the standard for assessing value has long been the ITR that is provided on Form 712. For modern-day insurance products, such as universal life and sophisticated term products, Form 712/ITR **does not equal** fair market value. Often, tax practitioners using Form 712/ITR are missing an opportunity to save clients six to seven figures in taxes.

ITR is a calculation that was designed for whole life and annual renewable term products and is usually dependable for those products. However, when it comes to the calculation of ITR for modern-day insurance products, each carrier uses their own methods of calculation, and ITR estimates of FMV can vary greatly from one carrier to another. To make matters worse, carriers are reluctant to stand behind their ITR calculations because of legal concerns.

This takes us back to lifestyle credits and a more customized or personalized underwriting picture. Who would have ever considered increased trans-



parency in health underwriting could have been the missing ingredient in planning? Most clients who have substantial amounts of life insurance held in an irrevocable life insurance trust (ILIT) are in the mid- to high-income range. They are quite likely to outlive mortality-based estimates of life expectancy and can benefit greatly from longevity-based credits with a customized analysis.

How do these credits affect estimates of FMV? If your client has a longer life expectancy than the average or median life expectancy for their age, then the FMV decreases proportionately. Here's how that translates into potential tax savings: It's not uncommon to see a six to seven figure Form 712/ITR value on a large life insurance policy. Many of those same policies have minimal cash surrender value. For healthy clients aged 60 plus, the FMV from an independent appraisal rarely exceeds the cash surrender value.

Practice Tip: Planners should never order a formal Form 712 for modern-day products without first requesting a fair market value appraisal and understanding the implications. Once the Form 712 is produced, its value is considered irrevocable.

This is one area where planners can take the extra step of getting an alternative FMV valuation to keep their client's plans from going awry. Also, no apologies will be needed. On the flip side, if the planner did not get an independent appraisal and instead used the 712/ITR, an apology might not be accepted once the beneficiaries discover the oversight on the part of the planner.

Market-based Life Insurance Valuation Methodology

Universal life insurance was introduced in 1979 and it took 34 years for valuation methodology to catch up with these hard to value assets. The IRS defines FMV as "the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts." A robust, regulated, and transparent secondary market for life insurance now provides reliable data to determine the FMV of life insurance based on willing buyer/willing seller principles. Remember, the estimates of FMV provided by the insurance carrier are health agnostic and therefore do not reflect the actual present health of the insured.

New market-based secondary market valuations (SMV) differ from standard appraisal methods and carrier estimates of FMV in five ways:

1. The SMV is based on a full set of objective transactional data and comparables from current institutional buyers that represent a true willing buyer/willing seller environment.
2. It provides a longevity data point useful for estate and tax planning and complicated hold/pay/change/sell decisions for senior clients.
3. These data points include an in-depth analysis of the current health conditions of the insured to determine life expectancy. No medical exam or paramedical exam is required. Medical records for the past five years are examined, and a series of credits and debits are applied based on medical conditions, activity level, and family history. Independent third-party life expectancy reports are obtained to provide further definition to mortality assumptions.
4. The appropriate discount rate is derived from cash flow analysis of current life settlement market transactions (not historical transactions) for real-time comparable data.
5. The policy type, policy values, current premiums, features, carrier rating and the portfolio needs of the institutional buyers, as they are at the time of the valuation, provide additional considerations for debits and credits and the resulting discount rate.

Market-based valuation methods result in a valuable time-stamped, mark-to-market appraisal that provides more certainty for complicated planning

continued on page 6

Longevity

continued from page 5

scenarios. It gives attorneys and planners a more defensible appraisal of FMV to use as an additional longevity and financial data point when making decisions about which value to select for FMV. More detailed information about market-based valuations can be found in the November 2016 edition of *Trust and Estates* magazine, "Rethinking Life Insurance Valuations for Seniors" by Jon B. Mendelsohn.

Do You Need to Amend Your Planning Strategy for Some of Your Senior Clients?

By now you may have recognized that market-based life insurance valuation methodology can provide a logical and defensible data point that can help your senior clients in two ways with universal life and term products:

1. If your client is **healthy** and is transferring a policy, an SMV will often validate that the FMV of your client's policy is no greater than the cash value.
2. However, if the SMV indicates that your client's policy has significant value beyond the cash surrender value because of **health issues** that are not cancelled out by credits, it enables you to consider monetizing the policy. This can be a valuable discussion if the insurance is no longer needed, has become a financial burden to maintain, or if your client just wants to reallocate future premiums and settlement proceeds to other planning needs.

In the November 2016 issue of *Estate Planning,* Marty Shenkman discussed the evolving role of the "Estate Planner as Estate Counselor." He explains how the role as estate tax minimizer is shrinking while the scope of what constitutes estate planning is broadening. He states "the traditional family of mom, dad, and children account for only about 20 percent of family units."

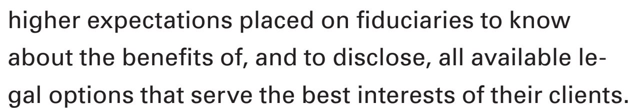
It reminded me of discussions we have when collaborating with other advisors and the increasing number of valuations attorneys who are working with mixed families are requesting to avoid potential litigation from beneficiaries in a trust-to-trust sale. Having an independent market-based appraisal using the willing buyer/willing seller rule, gives advisors a more reliable data point. SMVs are also frequently used for other situations, such as:

- When a policyowner gifts the policy
- When the policyowner predeceases the insured and the value is needed for estate tax purposes
- When the policyowner sells the policy
- When value is needed for business valuation purposes
- When value is needed for minimum distributions from qualified plans
- When value is needed to provide long-term care benefits for potential Medicaid recipients
- Transfer from a corporation to a trust
- Risk mitigation for ILIT trustees
- Nonprofit portfolio management
- Charitable income deduction
- Term policy valuations
- Helping Generation 2 (sandwich generation) deal with the financial impact of caregiving needs for Generation 1 (their parents).

Are Your Well-laid Plans About To Be Trumped?

Are you prepared to act quickly if the estate tax is eliminated entirely for a period of time, whether short or long? The Affordable Taxpayer Relief Act (ATRA) of 2012 already made it imperative to review significant amounts of life insurance for many wealthy people. Did any of your clients reduce or eliminate insurance coverage as a result? Did you secure an SMV to make sure that they weren't leaving any money on the table?

If you missed that one, you may get a chance at a do-over. Will you be prepared if the estate tax is eliminated in the future? As consumer education increases about the ability for policyowners to sell their policies for more than the cash surrender value, there will be



higher expectations placed on fiduciaries to know about the benefits of, and to disclose, all available legal options that serve the best interests of their clients.

A Word of Caution Regarding Disintermediation vs. Proper Representation

What do reverse mortgages, structured settlements, and direct life settlements have in common? They lack competition from multiple buyers, do not provide any representation for the policyowner, and eliminate the highly valued counsel from trusted advisors. Direct to consumer advertising to policyowners by life settlement funders has increased significantly over the past year. In most cases, they are focused on disintermediation of financial professionals, fiduciaries, and life settlement brokers, all of whom represent the seller's best interest. Your clients are being enticed by these direct buyers to cut out the middlemen to reduce intermediary fees so that the client gets more money. By eliminating client representation, these direct buyers are able to take advantage of unsuspecting consumers. They are spending millions on advertisements and using call centers to lure seniors into believing they are better off without representation.

As a result, the direct offers being made by these outlets and accepted by your clients are grossly undervalued, cheating your clients of possible value and putting the advisor or trustee's reputation at risk. It's only a matter of time before we see a lawsuit for senior abuse.

Why is this happening? Advisors and clients historically have not been aware of the right questions to ask about who represents whom in the transaction. Is there an alignment of interests or are there competing motives? Do they purchase policies for investment or do they have any ownership stake in companies that do? Sources that are representing the buyer have a fiduciary duty to their fund to get the greatest internal rate of return. Their goal is to spend the least amount of capital possible when purchasing policies. Those representing buyers and deploying capital in the life settlement market are similar to other asset classes and are looking for the best deals and highest rates of return. That's how they stay in business.

Fortunately, there are licensed professionals called life settlement brokers that do not sell life insurance or other financial products that exclusively represent clients and their advisory team. Life settlement brokers have a fiduciary duty to advisors and clients in order to receive the best offer possible. These professionals have developed competencies in analyzing policies and secondary market underwriting, while shopping the entire market to create competition. Without that competition, your client will not get top dollar. By understanding how to strategically approach the bidding process, it is common practice to increase an offer 5-10 times more than the first offer. Many times the final offers are negotiated from the initial buyers that were "low-balling" from the very start. Having a life settlement broker with years of inside-the-industry experience provides an advantage and the due diligence many advisors need when documenting their client files.

Make sure you choose a resource that represents you and your client so that your client gets the value they deserve and you can have a layer of protection that shows you completed your due diligence in serving the client.

Conclusion

An independent analysis of the specific life expectancy and life insurance FMV that includes health and lifestyle credits can provide a valuable data point that has multiple planning applications with senior clients. The SMV works differently for seniors in good health than it does for seniors with serious health impairments.

In certain tax planning situations, senior clients who are in good health and live an active lifestyle, may benefit if their advisor uses the data point

continued on page 8

Longevity

continued from page 7

provided by the SMV in place of standard tax conventions where permissible. Also, with life expectancies increasing, many seniors and their advisors who are facing difficult decisions about the maximizing performance of life insurance portfolios and facing complicated hold/pay/change/sell decisions can also benefit from a market-based SMV.

What about seniors with impaired health who have policies they no longer need, can't afford, or they just want to reallocate premium payments to other planning needs? That's where the market-based SMV that uses willing buyer/willing seller principles provides a true representation of fair market value that can be six to seven times greater than surrender value.

Protect your senior clients and get them the value they deserve by securing an independent personalized life expectancy analysis and a market-based life insurance valuation. Knowing your client's specific time horizon will change senior planning, minimize damage, and mitigate risk even when your best-laid plans go awry. ■

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Jamie L. Mendelsohn is executive vice president with the Ashar Group/Ashar SMV and a thought leader in the secondary market for life insurance. She has been instrumental in the development of innovative market-based policy valuation of fair market value, the SMV (Secondary Market Valuation) and has earned the reputation as a determined client advocate in the life settlement market. Jamie is a frequent speaker on life settlement topics.

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