October 15, 2009

To Members of the President's Economic Recovery Advisory Board Subcommittee on Tax Reform:

On behalf of the Association for Advanced Life Underwriting, American Council of Life Insurers, GAMA International, National Association of Independent Life Brokerage Agencies, and National Association of Insurance and Financial Advisors, we are pleased to submit the attached document for review by the Subcommittee on Tax Reform.

Over 75 million American families count on life insurers' products to protect their financial future. The attached document details the role of life insurance, annuities, long-term care and disability income insurance, and retirement products in those families' financial security. Whether acquired individually or through the workplace, these products demonstrate the vital role of the long-standing tax policy that encourages Americans to take individual responsibility for the financial futures of their families and businesses.

Each of our associations stands ready to assist the Subcommittee in its deliberations and would be pleased to provide additional information or answer any questions about the products life insurers provide.

Sincerely,

American Council of Life Insurers
Association for Advanced Life Underwriting
GAMA International
National Association of Independent Life Brokerage Agencies
National Association of Insurance and Financial Advisors

American Council of Life Insurers (ACLI) represents 340 companies that account for 93 percent of the life insurance industry's total assets in the United States. Members offer life insurance, annuities, pensions, including 401(k)s, long-term care and disability income insurance and reinsurance.
Contact: Walter Welsh, 202-624-2157, walterwelsh@acli.com

Association for Advanced Life Underwriting (AALU) represents 2,000 life insurance agents and financial advisors nationwide. Most members are engaged in complex uses of life insurance such as in business continuation planning, estate planning, charitable planning, retirement planning, deferred compensation and employee benefit planning. Contact: Marc Cadin, 703-641-8122, cadin@aalu.org,

GAMA International is a worldwide association serving 5,500 field leaders in the insurance and financial services industry. The association provides its members with professional development resources and opportunities, including educational, networking and leadership.
Contact: Brendan Gleason, 703-344-3688, bgleason@gamaweb.com

National Association of Independent Life Brokerage Agencies (NAILBA) is the premiere insurance industry organization promoting financial security and consumer choice through the use of independent brokerage distribution. NAILBA member agencies represent 250,000 producers who deliver more than four billion dollars in first year life insurance premiums annually.
Contact: Janay Rickwalder, 703-383-3071, jrickwalder@nailba.org

National Association of Insurance and Financial Advisors (NAIFA) comprises more than 700 state and local associations representing the interests of approximately 200,000 agents and their associates nationwide. Members focus on one or more of the following: life insurance and annuities, health insurance and employee benefits, multiline, and financial advising and investments.
Contact: Mike Kerley, 703-770-8155, mkerley@naifa.org

LIFE INSURANCE: PROVIDING FINANCIAL PROTECTION

Life insurance is a key component of Americans' ability to take individual responsibility for the financial futures of their families and businesses. It is unique in guaranteeing the delivery of financial security at precisely the moment it is needed, while contributing significantly to the nation's storehouse of savings and investment capital.

Life insurance enables individuals and families from all economic brackets to maintain independence in the face of financial catastrophe, helping relieve pressure on government entitlement programs. For this reason, there has been strong public support for continuation of current tax policy for life insurance products.

Success of the Product

Life insurance protects families from financial loss from the death of a loved one. It enables families to pass on more assets from one generation to the next, providing reliable liquid assets to pay for death-related expenses. Very few Americans can self-insure the risk of premature death through their own financial means. Life insurance makes managing this risk affordable through the pooling of risk.

Permanent life insurance has an additional advantage—it is guaranteed to remain in force for one's whole life, regardless of age. By design, the premiums of permanent insurance are used to both pay for the term cost of a policy's face amount and to create a savings component (cash value), which helps cover the rising cost of insurance as one gets older. If an insured's needs change and death benefit protection becomes less acute, the policy's cash value can be used to pay various expenses, such as tuition or long-term care. Or, the cash value can be converted into a retirement income producing annuity, an option also available to beneficiaries of life insurance policies. Some policies allow an insured to collect all or part of the death benefit if he or she becomes terminally or chronically ill.

Businesses use permanent life insurance to protect against financial uncertainty and secure their employees' futures. By owning life insurance on key employees, businesses have secure funding to pay for employee and retiree benefits and to protect jobs and families from financial loss and instability that can result from the death of an owner or key employee.

Current Tax Treatment

Since its inception in 1913, the tax code has provided that death benefits—and the cash value in permanent life insurance—are not subject to income tax. Premiums are paid with after tax dollars—there is no deduction for premiums paid. Earnings on a permanent life insurance policy's cash value are not taxed as long as the policy remains in force. However, if a policyholder gives up his or her insurance protection, earnings in excess of the total premiums paid are subject to tax.

The protection afforded by life insurance is an important societal benefit that public policy has consistently validated. This policy has been reviewed several times over the last century, and each time Congress has chosen to preserve the tax treatment of the product. Any changes to public policy must not limit or disadvantage the critical protection only permanent life insurance can provide.

ANNUITIES: CREATING GUARANTEED INCOME FOR LIFE

With the decline of defined benefit plans and the rise of defined contribution plans, such as 401(k)s, responsibility for managing retirement savings has shifted from the employer to the individual. Unlike traditional pensions that provide a stream of payments for life, defined contribution plans typically offer a lump sum that retirees must then manage on their own.

Other than Social Security and the defined benefit system, the only means to create a guaranteed income stream in retirement is through an annuity. An annuity is an insurance contract that offers an efficient solution to what otherwise could be an overwhelming asset management task: creating a steady paycheck in retirement that cannot be outlived.

Individuals without access to workplace retirement savings plans have an even greater challenge: to independently accumulate savings during their working years and manage those savings to last throughout retirement. An annuity can address both of those needs.

Success of the Product

The lifetime income option through annuitization allows retirees (and their spouses) to maximize retirement income without having to worry about payments stopping while they are alive. At the time of purchase, annuity owners are guaranteed that if they choose to annuitize at a later date, they will receive a benefit based on the purchase rates at the time the annuity was issued or annuitized—whichever rate is more favorable to the annuity owner. Given the changes that can occur over time with respect to the economy, longevity, or an insurer's costs, this is a valuable consumer benefit.

Annuities are popular among middle-income Americans: eight out of 10 annuity owners have income below $100,000. Almost half (42%) have annual income below $50,000.[1]

Current Tax Treatment

By encouraging long-term savings during the working years and helping individuals manage assets during retirement, the current tax treatment of annuities promotes financial discipline. For those who are years away from retirement, or are retired and have assets that don't need to produce income right away, a deferred annuity allows savings to build up, free of current federal income tax. When payments are received, the portion that comes from earnings is taxed as ordinary income. To encourage long-term savings for retirement, there are tax penalties for withdrawals from deferred annuities before age 59½ in addition to the income tax due on earnings. The tax penalty is not applied to certain lifetime payouts, death benefits, or payments made if an annuitant becomes disabled. Other exceptions may apply.

LONG-TERM CARE INSURANCE: PROTECTING RETIREMENT SAVINGS

A lifetime of retirement savings can be wiped out by an unexpected need for nursing home, assisted living, or at-home care. Today, a one-year stay in a nursing home averages $75,000. In 30 years, the cost is projected to exceed $270,000 per year.[2]

Health insurance plans generally do not pay for long-term care services. Many Americans also mistakenly believe Medicare will cover costs. However, Medicare provides skilled nursing home care only for a short time following hospitalization and limits help at home to those who need skilled nursing care and rehabilitative therapy. Middle-income individuals may qualify for long-term care under Medicaid, but only after spending down their savings.

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[1] Committee of Annuity Insurers, 2009 Survey of Owners of Non-Qualified Annuity Contracts (Conducted by The Gallop Organization and Mathew Greenwald & Associates)

[2] Genworth Financial, *2009 Cost of Care Survey*, April 2009, and ACLI estimates

Success of the Product

Long-term care insurance can protect individuals and families from financial crisis, and at the same time, alleviate the strain on public programs. Those who have long-term care insurance received $5 billion in long-term care benefits in 2008.[3] Long-term care insurance can cover services provided at home, in a nursing home, in a community-based care facility—such as an adult day care—or in an assisted-living setting. Today's policies also provide support for family caregivers.

Long-term care insurance also can be combined with life insurance. In addition, a 2006 federal law will allow long-term care insurance to be combined with an annuity—providing consumers with increased flexibility as their needs change in retirement. Beginning in 2010, an individual could accumulate assets in an annuity during working years; at retirement, that annuity could be used to provide lifetime income. If needs dictate, the long-term care insurance benefit within the annuity could be used to pay for services.

Current Tax Treatment

Long-term care insurance premiums are paid after-tax; a portion of premiums and out-of-pocket expenses may be deducted from federal income taxes as part of medical expenses, but this deduction is limited to amounts in excess of 7.5 percent of annual income. Some states provide either a tax deduction or tax credit for long-term care insurance premiums.

DISABILITY INCOME INSURANCE: PROVIDING PAYCHECK PROTECTION

A serious illness or injury can harm more than one's health—it can impact an individual's ability to work and pay living expenses. A disability also can disrupt one's retirement planning. The risk of becoming disabled is quite high—45 percent for people between 35 and 65.[4] In the event of a serious illness or injury, the benefit from employer and government programs—such as sick leave, short-term disability and Social Security—may not be enough to meet all of one's financial needs.

Success of the Product

Disability income insurance provides critical income protection for working-age people who find themselves unable to work due to illness or injury for a prolonged period of time. It pays individuals a portion of earned income—typically 50 to 70 percent—until they are able to return to work. There are no restrictions on how the money can be spent. Some policies also cover expenses related to rehabilitation, retraining and workspace modifications to help individuals return to work.

According to the U.S. Bureau of Labor Statistics, at least 35 percent of workers are covered by disability income insurance.[5] In 2008, life insurers paid $16 billion in disability income insurance benefits.[6]

Current Tax Treatment

Benefits received from an individual disability income insurance policy typically are not subject to income taxes. Benefits are taxed, however, if an employer pays for the coverage.

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[3] ACLI calculations of NAIC data
[4] JHA Disability Fact Book, 2003/2004
[5] United States Department of Labor, Bureau of Labor Statistics. Employee Benefits Survey. March 2008.
[6] ACLI calculations of NAIC data.

PENSIONS, 401(K)S, AND IRAS: BUILDING RETIREMENT SAVINGS

The employer-based retirement system provide working Americans with incentives to save for the long-term—minimizing the risk of inadequate savings at retirement. The life insurance industry is one of the largest providers of products and services to employer-sponsored retirement plans. Twenty-two percent of the assets in employer-based retirement plans in America are managed by life insurers.

For workers without access to workplace plans or for those who want to supplement savings, there are individual retirement accounts (IRAs).

Success of the Retirement System

In 2007, approximately 60 percent of workers were offered a retirement savings plan through their employer.[7] These include traditional defined benefit pensions, profit-sharing plans, and defined contribution plans, including 401(k)s, 403(b)s, and 457s. The flexibility in the current retirement system provides employers—including large and small businesses, schools, and all levels of government—with the flexibility to choose the retirement savings vehicle to best meet its operational and workforce needs.

Over the years, defined benefit plans, defined contribution plans, and IRAs have been incredibly successful in helping Americans build their retirement nest egg.

Current Tax Treatment

Employment-based retirement savings vehicles provide tax incentives to employers and employees to encourage long-term retirement savings. An employer's contribution to workplace retirement plans on behalf of employees is tax deductible. The tax treatment of a worker's contribution depends on whether contributions are made on a traditional or Roth basis. For traditional plans, contributions are made on a pre-tax basis; and taxes are not due on contributions and earnings until money is withdrawn. For Roth plans, contributions are made on an after-tax basis and, for qualified distributions, earnings are tax free.

Contributions to traditional IRAs are tax-deductible and tax on earnings in all IRAs is deferred.

For many moderate income workers, tax deductions and exclusions make it more affordable to save. For lower income workers, an additional retirement savings tax credit (the Saver's Credit) can further reduce their tax bill. Restrictions and penalties apply for early withdrawal of retirement savings (i.e., before retirement or disability). These restrictions exist as a trade-off for the valuable tax incentives these retirement savings vehicles provide and are designed to help ensure savings remain and grow until workers reach retirement. The current tax incentives afforded employer-sponsored retirement plans and IRAs are effective ways for workers to save. Maintaining and strengthening the current system is the most effective way to help working Americans achieve the dream of a comfortable retirement.

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[7] Congressional Research Services, "Pension Sponsorship and Participation: Summary of Recent Trends," Patrick Purcell, September 8, 2008.