

**HARRY R. WIGLER, CPA/PFS**  
**Tax Planning & Preparation**  
**Wealth Accumulation & Income Protection**

80 Crossways Park West • Woodbury, NY • 11797  
Phone: 516-677-5015 • Fax: 516-677-7916



APRIL 2009

***“Money is only a tool. It will take you wherever you wish,  
but it will not replace you as the driver.”***

*- Ayn Rand*

## THE ISSUE IS INCOME

The bottom-line objective of any individual financial program is to provide an ongoing stream of income to meet the necessities and pleasures of life. Market values for different assets might add up to significant net worth, **but net worth doesn't buy groceries, pay the bills or take you out to dinner; your income does.** People pray “give us our daily bread,” not “give us asset appreciation.”

This issue emphasizes the primary position of generating income in your financial programs, because income is what makes all other financial decisions possible.

### **THE ISSUE IS INCOME: How Long Can Your Human Asset Keep Paying Dividends?**

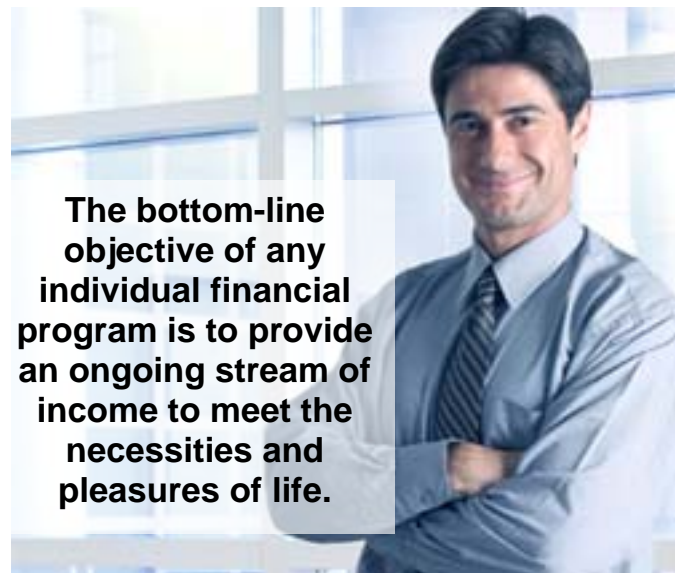
When it comes to asset values, we know the numbers are ugly. How ugly?

- In the 2008 calendar year, the S & P 500 stock market index registered a 37% decrease, its worst calendar year performance since 1931. From January 1, 2009 to March 19, 2009 the index has declined an additional 15%.
- Meanwhile, the Federal Housing Finance Agency reported on February 24, 2009 that home prices dropped 8.2% from a year earlier, the largest annual decline on record since 1991.
- In total, the Federal Reserve reported that the wealth of American families plunged nearly 18% in 2008 – a loss of net worth estimated to be around \$11 trillion.

But guess what? As securities and real estate markets have taken a pounding, another asset has returned to prominence. Featured on the cover of the March 23, 2009 paper version of *Time* magazine is the headline “**10 Ideas Changing the World Right Now.**” And according to *Time*, the No. 1 world-changing idea is...

### **...Jobs Are the New Assets.**

That's right; you – and your ability to deliver a steady income by working – are the “new” asset class



**The bottom-line objective of any individual financial program is to provide an ongoing stream of income to meet the necessities and pleasures of life.**

that can make a difference during this down economy. Here's an excerpt from the article, written by Barbara Kiviat:

**“Houses and stocks — those were the things we paid attention to, the things that gave us the confidence to be good American consumers (Hello, home-equity lines of credit). At the same time, the percentage of income we saved dropped and dropped and dropped — until, thanks to the power of credit cards and other debt — it went negative in 2005. That was neatly explained away by the ‘wealth effect’: we spent money we didn't have because we felt — and technically *were* — richer because of our assets.**

**All the while, we blissfully ignored a little concept economists like to call human capital. The cognition you've got up there in your head — your education and training — it's worth something. We can extract value not just from our homes and our portfolios but from ourselves as well. The mechanism for extracting that value? A job. ‘The income you earn from working is like the stream of interest income you might get from owning a bond,’ says Johns Hopkins University**

Here's a quick quiz on a financial concept.  
Do you know the answer?

## Financial Literacy Question

Answer on page 6



This is what **\$1 million** in \$100-dollar bills looks like.

### What does one TRILLION dollars look like?

In the past few weeks, we've heard our legislators discuss bailouts and stimulus packages that could exceed one **trillion** dollars. We know that's a lot of money (It's 1 with 12 zeroes after it), but after awhile, a number becomes so big it challenges our ability to comprehend it. So, unlike a typical Financial Literacy question, this one isn't multiple choice. Rather, it's a few word and picture images to give you a frame of reference. (For a full-blown treatment of the subject, check out the illustrations and images at <http://www.pagetutor.com/trillion/index.html>.)

First, consider that a packet of one hundred \$100 bills is less than 1/2" thick and contains \$10,000. (As the web site notes, this amount of money "fits in your pocket easily and is more than enough for a week or two of shamefully decadent fun.")

Thus, it takes 100 packets of \$10,000 to equal \$1 million dollars. As you can see from the illustration, you could easily put your million in a grocery bag and walk around with it. (Turn to page 6 for the rest of the story...)

Continued from previous page...

### economist Christopher Carroll. "Think of it as a dividend on your human wealth."

While it might make for nice headlines, identifying human capital as the core of financial prosperity isn't a new idea. From ancient cultures that penned proverbs extolling the value of work ("*Do you see a man skilled in his work? He will stand before kings...*") to 20<sup>th</sup> century champions of free enterprise and capitalism like Ayn Rand ("*Wealth is the product of man's capacity to think.*"), human capital has always been recognized as the key ingredient in creating wealth. Real estate doesn't gain value on its own – it has to be developed. An increase or decrease in stock prices ultimately reflects the decisions and productivity of the people in the company – both the employees and owners.

Given the media infatuation over the past decade with other assets, the article provides some much-needed financial perspective. Too often the most overlooked or undervalued financial asset is you and your abilities. Your ability to produce a regular income makes you a powerful dividend-paying asset, and it's the type of asset that satisfies the basic objective of an individual financial program: to provide an ongoing stream of income to meet the necessities of life – and hopefully afford some of the luxuries as well.

When stock market and housing values were soaring, some people lost this focus on income production,

because prevailing sentiment said you could always turn value into income at a later date by selling or borrowing against the assets. But when values decline and borrowing standards tighten, the assets don't have the same convertibility.

### Building Up Your Human Capital

This sounds obvious, but in a time when other asset classes are faltering and the economy is struggling, steady income from a job is critically important to your long-term financial well-being. And like any other business that wants to remain profitable, your human capital must remain competitive in the market place. You may need to consider an investment in continuing education, or an upgrade in your technology skills. And "under-employment" – i.e., working in a position below your qualifications – may be better than not working, because of the future opportunities that may arise from connections with other productive people.



But even if you remain employed, there are other threats to your human-capital dividend production. Your human capital doesn't last forever. At some point, you may get tired or break down. Eventually age takes some or all of your productive capacity. So unless you die young, it isn't reasonable to expect you will remain fully productive for your entire life. This is the biggest financial challenge in using human capital to provide an ongoing income: At some point, there will need to be a transition from income/dividends from your human capital to income/dividends from other capital. But when?

### The Longevity of Human Capital

The statistical realities of human capital in developed nations are eye-opening.

First, consider life expectancy. According to the Social Security Administration, a 40-year-old American male has an average life expectancy of another 37.28 years. (See Fig. 1 for life expectancies at other ages). And the older you are now, the greater your life expectancy – while an average 40-year-old male can expect to live until 77, an average 60-year-old male can expect to live to 80.

But there's a distinction between being alive and being healthy enough to work. In most cases, people will not be able to work as long as they are alive. To account for this distinction, longevity statisticians have developed a Healthy Life Expectancy (HALE) calculation. HALEs (pronounced *haleys*), are defined as the average number of years that a newborn can expect to live in "full health," and are used by statisticians to

adjust life expectancies for the amount of time spent in poor health.

The World Health Organization (WHO) provides a HALE calculation for each country in the world. In the United States, the current HALE is 67.0 years for males and 71.0 years for females. When compared with current life expectancies for newborn Americans, the difference is 8 years for males and 9 years for females. From this data, it might be possible to consider average human capital to be “used up” 8 or 9 years before the end of one’s life.

But this data is for newborns – those born today. Other current information, while not providing an apples-to-apples comparison with the HALE data, is even more sobering:

The following statistics come from reports issued by the Urban Institute in December 2008 and February 2009:

- About one-third of all Americans develop a health-related limitation in their fifties and sixties.
- Four in 10 workers in their fifties have jobs with some physical demands, which they might not be able to meet as they grow older.
- Even for workers in jobs that aren’t strenuous, health problems can keep many from working. More than a quarter of adults age 65 to 69 have a health problem that limits the work they can do.
- As a result, 37% of American workers do not retire on their own timetable, but rather are forced into retirement due to layoffs, illnesses or injuries.

In other words, human capital, while the key to all wealth production, is a fragile asset. It needs to be protected, and eventually, must be replaced by other assets.

### Protecting Your Human Capital

Some of the best protection for your human capital is simple self-maintenance. Eating sensibly, exercising, and avoiding bad habits are not guarantees of a long HALE, but all evidence points to a clear correlation. Good health is essential to maximizing the value of your human capital. The longer you can produce an income, the greater the likelihood of financial security.



***The rest of your human capital protection issues are best handled through insurance.***

In the insurance business, there’s an old analogy that compares your human capital to a business machine that

generates thousands of dollars in income per year. Considering its value, it makes sense to insure the machine (you) for direct damages, as well as coverage for lost income if the machine were broken or worse yet, if it were destroyed. Life, health and disability insurance exist to protect against the risks to your personal wealth-generating machine.

If you are unable to work due to sickness or injury, health insurance is designed to cover “repair” costs, as well as provide an ongoing income during the period you are “out of service.” If your injury or illness is more long-term, disability insurance helps supplement your lost income. And if you are no longer able to provide for your dependents because of death, life insurance is designed to provide assistance for final expenses and ongoing income.

Because a major medical incident has the potential to cause the most immediate financial damage, health insurance seems to be a front-and-center issue for workers, employers and politicians. But the current obsession with solving the health-care crisis shouldn’t obscure the need to address individual disability and life insurance issues as well.

### Don’t Undervalue Your Human Capital

A lot of space in the popular financial press is consumed with dissecting the fallout from the decline in asset values. Experts are trying to determine when the stock and real estate markets will rebound. Individuals are trying to decide if they should continue to buy-and-hold or cash out. These are important issues and legitimate financial concerns because assets, cash, stocks, bonds, and real estate have a place in your financial life.

But perhaps current events are also helping to reshape their importance of these types of assets in relation to the essential position human capital holds in every individual’s financial program. Developing and protecting your human capital sets the stage for long-term financial success – in all types of economic conditions. More than any prognostication or rearrangement of your other assets, your human capital is the one asset most likely to carry you through tough economic times.

This awareness should prompt some assessment of the condition of your human capital.

- Should your human capital be upgraded through education or the acquisition of new skills?
- Is your human capital healthy, or should you implement a better maintenance plan?

**FIG. 1**  
**Period Life Table, 2004**  
*from the Social Security Administration*

<u>Exact Age</u>	<u>Male Life Expectancy (yrs.)</u>	<u>Female Life Expectancy (yrs.)</u>
40	37.28	41.46
45	32.78	36.80
50	28.46	32.25
55	24.33	27.81
60	20.36	23.53
65	16.67	19.50
70	13.27	15.72
75	10.24	12.29
80	7.62	9.22
85	5.45	6.62

- Have you adequately protected your human capital?
- Is now a good time to use other assets to improve your human capital?

**WHEN OTHER ASSETS START TO SLIDE, YOU WANT TO BE SURE YOUR BEST ASSET IS ON SOLID GROUND. DOES YOUR HUMAN CAPITAL NEED AN “ASSET CHECK?”**

**THE ISSUE IS INCOME: A Longevity Annuity as “Income Insurance”**

Here’s an intriguing financial transaction:

A 60-year-old man places a small portion of his retirement savings in an annuity that will produce a guaranteed income once he reaches an advanced age, say 85. Based on current assumptions, here are some details: On a deposit of \$50,000, the annuity is guaranteed to pay \$5,211 a month, beginning at age 85 – for the rest of his life – no matter what happens to interest rates or mortality costs in the future.

If you do some future value calculations, the rate of return of the \$50,000 placed in the annuity seems pretty high; at 6% annual interest, it would take more than \$1 million in assets to provide an equivalent ongoing income. But even over 25 years, \$50,000 would have to earn an average annual return of almost 13% to equal \$1 million. So how does a longevity annuity achieve this result?

One key feature: If the policy holder dies before age 85, the annuity expires without value. Heirs receive nothing.

As John Olsen, a Chartered Life Underwriter from Kirkwood, MO writes in the January 2009 issue of the trade publication *Life Insurance Selling*,

**“Why would anyone buy such a thing?**

**Why buy a policy that won’t pay him a penny for 25 years and if he doesn’t make it that long, he loses his entire investment? Sounds like a very bad investment.”**

But Olsen goes on explain this annuity, known as an *advanced life delayed annuity*, or *longevity annuity*, is not an investment. “It’s a risk transfer instrument — a pure insurance play. The risk that the purchaser transfers to the issuing insurer is the risk he’ll run out of money at an advanced age (when he cannot expect to earn income).”

The structure of longevity annuities are not limited to deposits at age 60 and payments at age 85. Deposits can be made as early as age 40, and payments can begin earlier as well. Earlier deposits will generate higher payments. Payment at younger ages will result in lower monthly amounts.

Longevity annuities are relatively new products in the marketplace, but have received some surprisingly positive reviews from the popular press, all because of the guaranteed income feature. In a January 21, 2008, *Money* article, senior editor Walter Updegrave writes:

**To my mind the concept behind longevity annuities makes a lot of sense. In effect it's like buying a homeowners or health insurance policy that has a very large deductible. You're insuring yourself against a catastrophic risk you can't handle on your own - in this case, running out of money late in life - while holding your premium to a minimum.**

**You guarantee yourself an income to cover your spending late in retirement while leaving more of your savings available to you today (or available to your heirs if you die young). And you can comfortably spend down a greater portion of your savings earlier in retirement, knowing that those longevity annuity payments will eventually kick in.**

Martha Hamilton, writing in the *Washington Post* (“Live Long and Prosper,” August 12, 2007), emphasizes the cost-effective way that insurance can handle the need for income later in life.

**You buy insurance because you get protection from a possible disaster at a reasonable cost. Same thing with a longevity annuity. It's insurance that you won't end up living on nothing but Social Security if it turns out that there's more life at the end of your money than money at the end of your life.**

**The Spend-Down Concept Behind the Longevity Annuity**

In examples used to illustrate the financial effectiveness of a longevity annuity, the hypothetical policy buyer allocates between 5-15% of his/her current accumulation to a longevity annuity; a 60-year-old with a \$1 million portfolio sets aside \$50,000-\$150,000.

Even though buying this “protection” decreases the overall account balance, having the longevity annuity allows one to “spend down” assets over a specific period of time instead of living only on interest or investment earnings and preserving principal. The insurance allows other assets to be spent more efficiently – in other words, more income is derived from the assets.

According to an online article from CNN/Money ([money.cnn.com/retirement](http://money.cnn.com/retirement)), putting 10% to 15% of retirement savings into a longevity annuity “provides roughly the same spending power as devoting 50% to 60% of savings to an immediate annuity, according to a paper by Jason S. Scott, retirement research director for Financial Engines of Palo Alto, Calif.”

## Another Way to Accomplish the Spend-Down Concept

For those who own permanent life insurance, the spend-down concept may be executed even more efficiently. A life insurance policy that is in force in old age may have a significant value as a cash asset, as investors or financial institutions might be willing to make either payments or a lump sum to the insured based on a collateral assignment agreement – in exchange for rights to some or all of the life insurance proceeds at death, the insured receives money now. Having the life insurance available as a back-up (a whole life insurance death benefit may grow in value as you grow older), you are free to spend more of your accumulated assets.

Further, the insured does not have to live to a specified age to enter into a collateral assignment or life settlement agreement. If certain health situations precipitate the need for additional assets, an Accelerated Benefit Agreement will provide payments directly from the insurance company – no investor or other third party is needed. And of course, if the insured dies before needing to enter into a collateral assignment or similar agreement, the life insurance proceeds are distributed income tax-free to heirs.

If you understand the spend-down concept behind the longevity annuity structure and already have permanent life insurance, it might make economic sense to allocate 5-15% of your annual retirement income to permanent life insurance premiums. If you don't have life insurance or find yourself uninsurable, a longevity annuity may be a suitable alternative.

### **THE ISSUE IS INCOME:**

#### **Non-cancelable, Guaranteed Renewable: Special language that protects the insurance that protects your income**

Disability income insurance policies can vary greatly as to contract language. Unlike life insurance in which death is easy to define, disability insurance contains different definitions of disability, and the definition plays a large role in determining how and when benefits are paid.

Besides the definition of disability, one other feature is unique to disability insurance: The renewability

feature. While life insurance premiums are based on set premiums for specified periods of time, not all disability policies have the same premium structure. There are basically three types of renewability clauses for disability insurance: renewable at the option of the insurer, guaranteed renewable, and non-cancelable guaranteed renewable.

**Renewable at the option of the insurer** allows the insurance company to change rates, contract language, and even cancel the plan. Many group and association disability insurance programs, such as those offered through employers, are renewable at the option of the insurance company. If claims are too high or some other factors make the coverage unprofitable, the insurance company can revoke the coverage.

**With a guaranteed renewable** contract the insurance company is obligated to renew the contract but does not have to guarantee the premium structure. This format allows you to keep the coverage as long as premiums are paid, but you run the risk of eventually being priced out of the protection. This is what one disability expert calls the "Vicious Circle of Disability Coverage:" Premiums are set; claims exceed expectations, so premiums must be adjusted upward. Healthy people leave the plan, new members do not sign up, leaving only older

and less healthy people in the group. Claims exceed expectations; premiums must be adjusted upward again.

A **non-cancelable guaranteed renewable** disability policy means the insurance company cannot change the premium or the contract regardless of claims, health of the insured, changes in occupation, etc. Only the insured can make changes to the contract or cancel it. This is the standard format for most individual disability policies, and from an insurance perspective, it is the best renewability feature to have.

It should be no surprise that the renewability feature in a policy has a big impact on the premium. Coverages that appear to offer the same benefits often have a substantial disparity in premium because of the non-cancelable guaranteed renewable clause. However, the end result of not having a non-cancelable guaranteed renewable feature is usually much more costly – and risky.

With a non-cancelable guaranteed renewable policy, you not only have certainty about future premiums and benefits, but you also have some protection against the devaluation of premiums already paid. Consider this



**When you make a decision to protect your human capital, make sure your disability insurance decision is about more than price. The degree of protection hinges greatly on the soundness of the features.**

example:

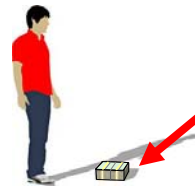
10 years ago, you established a non-cancelable guaranteed renewable policy, paying \$200/mo. for a \$3,000 monthly benefit in the event of your disability. Today, the value of the \$3,000 benefit has been diminished by inflation, but so has the cost of the premium, because the ratio of \$200/mo-to-\$3,000/mo. has stayed the same.

However, if you elected a disability contract with fluctuating premiums, it's quite likely the ratio of premium to benefits has changed as well as has been devalued by inflation. You may continue to pay more to get less.

When you make a decision to protect your human capital, make sure your disability insurance decision is about more than price. The degree of protection hinges greatly on the soundness of the features.

### FINANCIAL LITERACY QUESTION:

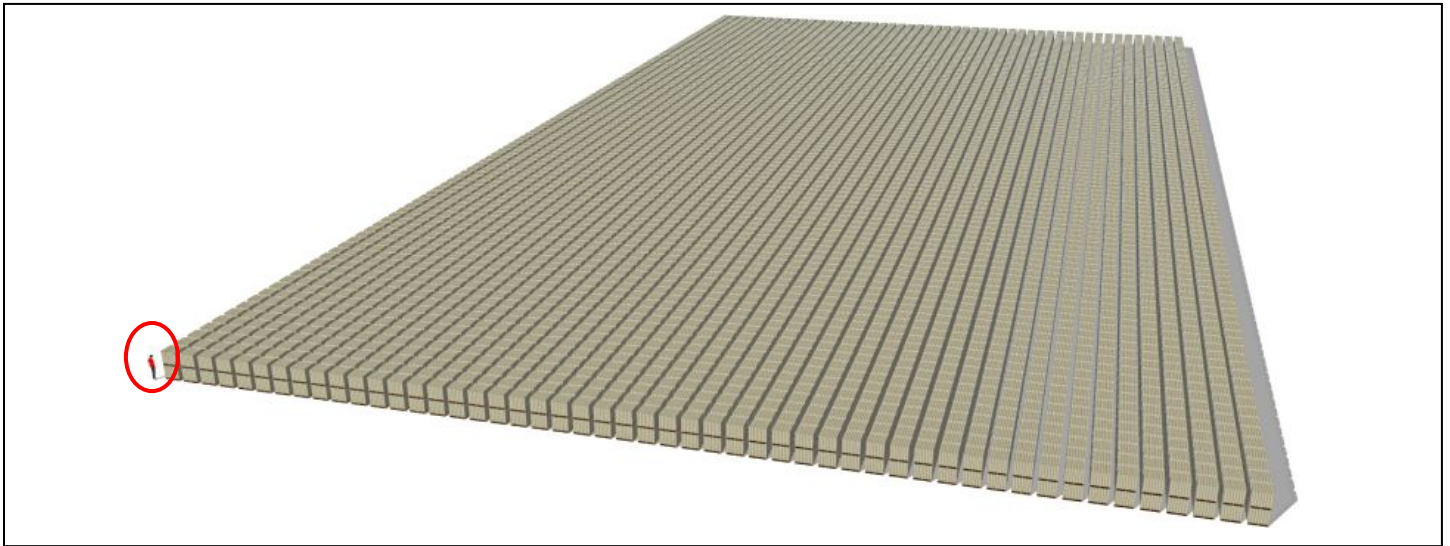
What does one TRILLION dollars look like?



This is what \$1 million dollars looks like (100 packets of \$10,000).

### BELOW IS A TRILLION DOLLARS!

Oh my! The tiny figure in the *lower left corner* is the same person who stood next to \$1 million on page 1. A trillion dollars represents *one hundred million* packets of \$100 dollar bills, double-stacked on pallets.



Material discussed is meant for general illustration and/or informational purposes only and it is not to be construed as tax, legal or investment advice. Although the information has been gathered from sources believed reliable, please note that individual situations can vary, therefore the information should be relied upon when coordinated with individual professional advice.

Harry R. Wigler, CPA/PFS  
80 Crossways Park West  
Woodbury, NY 11797  
Phone: 516-677-5015  
Fax: 516-677-7916