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Using Life Insurance for Income Protection and Retirement

Life insurance is most frequently used to replace lost income for a spouse or children when a family income earner dies. However, the death benefit from a life insurance policy originally bought for income replacement may also be used to help provide increased income for both spouses during their retirement years. In the right situation, this “combination of benefits” idea gives a good reason for buying a permanent and universal life insurance policy.

INCOME REPLACEMENT NEEDS AT DEATH

Protecting a family's income from the death of one or both income earners is a basic and well-recognized need that life insurance addresses. So why would someone need life insurance after retirement when earned income replacement is no longer important?

The reasons for owning life insurance after retirement are varied. However, for some married couples, permanent and universal life insurance can help increase the retirement assets of the surviving spouse, or of both spouses, as discussed below. In other words, life insurance that is in force at the death of the first spouse may allow both spouses to enjoy a higher income in retirement than they would otherwise have.

DEATH BENEFIT AND RETIREMENT PLANNING

The death benefit from a permanent and universal life insurance policy originally bought for income protection may *also* provide a retirement benefit for the surviving spouse. This income tax-free death benefit may allow both spouses to take greater retirement income than they otherwise could.

Without life insurance, a retired couple generally will plan to distribute their retirement capital over the life of the spouse with the longest life expectancy.

Women generally live longer than men—it is not unusual for a female to need income for seven to ten years after the death of her male spouse.

Genworth Financial companies include:

First Colony Life Insurance Company, Lynchburg, VA
GE Life and Annuity Assurance Company, Richmond, VA
General Electric Capital Assurance Company, Lynchburg, VA
Capital Brokerage Corporation, Stamford, CT

Variable products issued by GE Life and Annuity Assurance Company

Principal underwriter: Capital Brokerage Corporation (dba GE Capital Brokerage Corporation in MN, IN, NM and TX),
3001 Summer Street, P.O. Box 120041, Stamford, CT 06912-0041 Member NASD/SIPC

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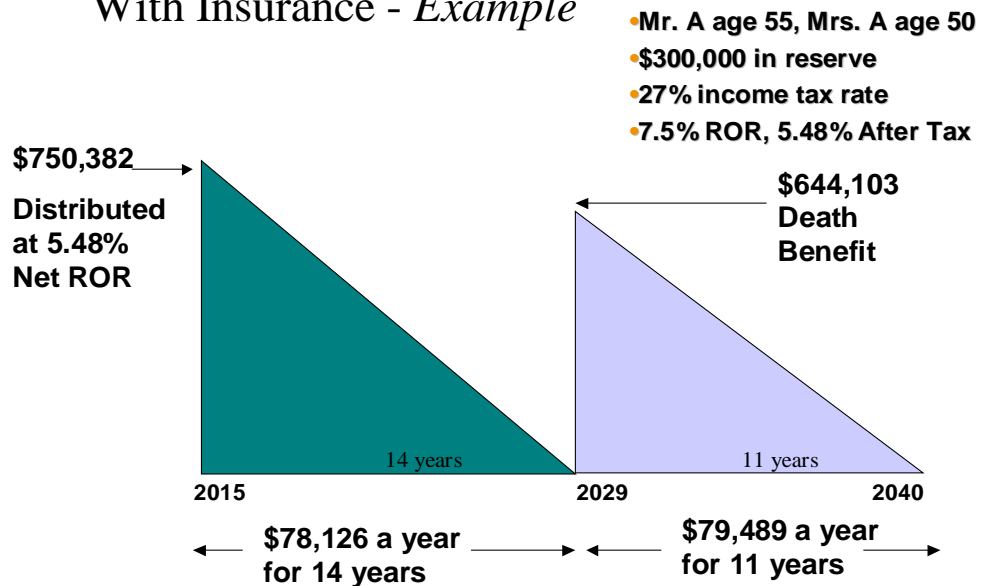
premium payments and lost earnings on those premiums (at a 5.48% after tax return) would reduce Mr. A and Mrs. A's savings by \$24,425 at retirement to \$975,575, and reduce their annual after tax retirement income from \$74,368 to **\$72,551**. Below is a diagram which illustrates the "no insurance" and "term insurance" options.

Scenario Two: Now let us assume that at age 55, Mr. A buys a \$450,000 Lifetime Protector FlexSM universal life insurance policy with a return of premium death benefit. The policy illustration assumes a Standard No Nicotine Use rating for Mr. A, premium payments of \$19,410 for ten years, a current non-guaranteed 4.5% interest rate, and the current cost of insurance rates for the life of the policy. At Mr. A's age 65, the \$1,000,000 the A's originally intended to liquidate for retirement income will have been reduced to \$750,382 because of the premium expense (life insurance premiums over a ten year period, plus lost earnings on those premiums).

However, because they own a life insurance policy, Mr. A and Mrs. A plan to spend the \$750,382 over Mr. A's shorter 14-year life expectancy. This produces an annual after-tax income of **\$78,126** for 14 years.

By the time Mr. A reaches his life expectancy of age 79, the policy death benefit of his life insurance policy is projected to be \$644,103. If Mr. A dies at this time, Mrs. A could liquidate the \$644,103 over her remaining life expectancy of 11 years for an annual income of **\$79,489**. Under this second scenario, the couple would have greater income distributions than under Scenario One for each year of Mrs. A's entire 25-year life expectancy. This is a total of over **\$108,943** more income over this period with no term insurance or a total of over **\$154,368** more income over this period if they had purchased ten-year term insurance.

With Insurance - *Example*



ASSESSING THE POSSIBLE OUTCOMES

Of course, no one knows when Mr. A will die. He could die before life expectancy, or he could live beyond it.

If Mr. A dies **before or at** age 79, he and Mrs. A clearly will have been receiving higher income distributions under Scenario Two with life insurance than under Scenario One without life insurance.

If Mr. A dies **after** age 79, he and Mrs. A can use their reserve (which should have grown from \$300,000 to over \$730,000 assuming an after-tax return of 5.48%) for the purpose for which it was intended: to provide income in case either of them outlive their life expectancy. In addition, they could take zero-interest or low interest loans on the cash values of the life insurance policy to provide additional retirement income.¹ When Mr. A dies, the death benefit can be used for Mrs. A's living expenses, or as an additional inheritance for their heirs.

If Mrs. A dies before Mr. A, then Mr. A's income distributions could be increased to provide more income under Scenario One than under Scenario Two. However, the extent to which the Mr. A could increase his distributions under Scenario One depends on how long Mr. A outlives Mrs. A. The likelihood that he will outlive her by a significant length of time is not high. Besides, Mr. A may prefer Scenario Two because it results in greater income distributions while both he and Mrs. A are alive.

TAX FREE DEATH BENEFITS MAY RESULT IN MORE RETIREMENT INCOME

Why are income distributions to Mr. and Mrs. A greater under Scenario Two, assuming the most likely outcome, that Mrs. A outlives Mr. A? The main reason is the income tax-free treatment of the life insurance policy death benefit. The gain in the life insurance policy (\$450,000 if Mr. A dies at age 79) is not income taxed when received as death proceeds. However, assumptions about interest rates, income tax brackets, death benefit options, and life expectancies also affect the outcome.

The primary purpose for buying life insurance is to provide a death benefit, especially to protect against the premature death of an income earner. However, the fact that life insurance can help a couple increase their retirement income may be a factor in choosing between a term life insurance policy that will end at retirement, and a permanent and universal life insurance policy that will more likely remain in force after retirement.

¹ Policy loans, partial surrenders and withdrawals have the effect of reducing the death benefit and surrender value. If a policy is surrendered, any outstanding loan balances will be used to determine whether there is a taxable gain in the contract/policy. In certain highly funded cases, life insurance policies may be considered Modified Endowment Contracts (MECs). In such cases, distributions will be taxable income to the extent that there is gain in the contract. In addition, a 10% IRS penalty tax may be due on any taxable income received prior to age 59½.

Lifetime Protector FlexSM universal life insurance is subject to the terms, issue limitations, and conditions of Policy Form No. ULFCL02SP et al. for First Colony Life Insurance Company, Lynchburg, VA, or Policy Form No. ULGE02SP et al. for General Electric Capital Assurance Company, Lynchburg, VA. Lifetime Protector FlexSM UL is not available in all states. Not all riders are available in all states.

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