

CREATIVE

Wealth Maximization Strategies

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“EITHER-OR” FIXATIONS IN LIFE INSURANCE: Are You Missing the “C” Option?

“C” = BOTH

“A”

“B”



*Steak or lobster?
Dogs or cats?
Ginger or MaryAnn?*

Why do some people insist on turning every issue into a black-or-white, either-or decision? In theory, this mindset might simplify one's life (or simply provide time-killing conversation at the local watering hole), but most of the time an either-or approach is neither necessary nor desirable; quite often, finding a “C” option is much better than choosing Option “A” and

rejecting Option “B” (or vice versa). Hey, why insist on diners having to choose between lobster or steak when they can have surf *and* turf, right?

The either-or mentality shows up with some frequency in financial commentary. For example: *Stocks or bonds? Pre-tax or after-tax savings? Group or individual benefits?*

Looking at these “A” or “B” sample issues, it should be obvious that “C” options are both available and practical. A balanced portfolio usually includes a mix of investment vehicles, not just one type. Pre- and after-tax savings plans each serve important functions in individual finances, depending on when the accumulation might be needed. And a blend of group and individual programs can provide customized security at an affordable price. Despite an attention grabbing either-or headline, the answer to most “A”-or-“B” financial questions is usually “C” – “both.” But what about this question:

Permanent or Term life insurance?

A quick survey of opinions about life insurance (in financial publications, at bookstores, on the Internet) finds mostly a polarity of opinions; it's either “A” or “B,” permanent or term. “C” options, those that might recommend both permanent *and* term, can hardly be found. But considering how many other financial issues seem to include practical “C” options, why is the discussion about life insurance so polarized and dogmatic? There are several possible explanations.

Why people can't seem to find the “C” option for life insurance

Permanent policies are complicated. In comparison to other financial products like stocks, bonds and mutual funds, permanent life insurance can legitimately lay claim to being the most complicated and multifaceted financial instrument available to the general public. This complexity is not only because permanent life insurance consists of a blend of savings and insurance benefits, but because different contract formats allow for an endless variation in how the cash values and insurance features can be combined to meet individual desires.

There is no uniformity in the evaluation process. How does an individual determine the financial value of life insurance? This is a challenging question, one in which there is very

In This Issue...

“EITHER-OR”
FIXATIONS IN
LIFE INSURANCE:
Are You Missing the
“C” Option?

Page 1

THE CONFOUNDING
TAX CONSEQUENCES
OF COMPLEX
FINANCIAL
INSTRUMENTS

Page 3

THE ECONOMIC COST
OF CARING FOR
ELDERLY PARENTS

Page 4

GETTING ORGANIZED:
Essential Documents
to store in one
file cabinet

Page 5

FROM 107 TO 1,124
IN 32 YEARS. *Should
you be impressed?*

Page 5

little consensus. For example: In a net worth statement, what is the value of a life insurance benefit? Until the insured has died and a claim has been paid, there is no recognized dollar value (for a term policy). Yet having life insurance certainly results in greater financial security. Because of the difficulty in quantifying the financial value of life insurance, the methods of comparing and evaluating life insurance are numerous, reflecting a broad range of financial philosophies.

Even for term insurance, where the typical method of evaluation is price (the lower premium is considered the best value), other factors come into play. A 10-year term policy will almost certainly be cheaper than a 20-year term, but what about the cost of maintaining or re-insuring when the term expires, especially if one's health changes? How can one accurately assess this factor from a financial perspective?

In some evaluations, critics of permanent life insurance will point to low rates of overall return in comparison to other accumulation vehicles. Yet permanent life insurance isn't just an accumulation vehicle; the life insurance benefit is part of the package as well, and the two components are interrelated. How accurate is an evaluation process that attempts to separate what was intended to be combined?

There are commissions involved.

Almost all life insurance is provided by agents who receive commissions from insurance companies when they help an individual obtain coverage. Permanent policies have larger premiums, and larger premiums mean bigger commissions. For some observers, this commission arrangement creates a conflict-of-interest for agents, in that they may be induced to recommend higher premium policies that are perhaps not suitable for consumers. Another frequent critique of permanent life insurance policies is that the agents' commissions come at the expense of greater cash values for the policyholder.

Over the past few decades, the combination of complex products, poorly defined evaluation processes and implied potential for a conflict of interest over commissions has led many public "experts" to offer this advice: "Just get term insurance. It's simple and cheap, and you won't have to worry about getting ripped off." In response, knowledgeable commentators within the life insurance industry often feel compelled to focus on strategies that justify permanent policies for almost every scenario, both to explain their products and defend their integrity. In a way, the strong philosophical differences about how to view the two forms of life insurance have left little room for discussing ways to make them fit together. Yet there are many workable formats for making life insurance a product with "C" options.

The "C" Options in Life Insurance

Both term and permanent policies have a long history in the marketplace because consumers have shown a demand for both forms of life insurance. Any economist would tell you that consumer demand validates the worth of a product or service. In real life, no matter what the "either-or" fixated experts might say, consumers find both term and permanent insurance are valuable financial products. Consumers shouldn't have to choose between the two products when they say they like both.

In general, both term and permanent insurance provide immediate financial protection, while permanent life insurance allows this protection to become a long-term financial asset. From a "C"-option perspective, a good life insurance plan would be one designed to deliver maximum immediate *and* long-term benefits. Fortunately, there are several ways to accomplish this objective.

Conversion provisions for term insurance.

Many term life insurance policies have provisions that allow the policyholder to convert some or all of the term coverage to a permanent policy, without requiring a new application or medical exam. Convertibility provisions allow you to start with Option "A" and change to Option "B."

Guaranteed increase options "GIOs"*. These provisions allow policyholders to increase their coverage by specified amounts at scheduled intervals. For example, a \$500,000 policy may give the policyholder the option to increase the insurance benefit by \$50,000 every three years for the first six years of the contract without additional underwriting. Some GIOs can be triggered by birthdays (age 30, 35, 40 etc.), while others may be available based on events (the birth of a child). GIOs are an acknowledgement that as circumstances change, there may be a desire for more coverage.

*GIO rider incurs an additional cost.

Blended contracts. Most life insurers offer contracts that blend term and permanent protection into one contract. Typically, this blend of coverage transitions over time from a high percentage of term at the beginning of the contract to a 100% permanent policy. This can be an effective way to secure maximum coverage now while providing a long-term insurance asset for retirement and estate planning purposes. Some of these contracts may require adjustment over time, but blended contracts are true "C" options in life insurance.

Dividend options. Many permanent policies feature dividend payments to policyholders. Dividends are a return of premium and while the typical default option is to add them to existing cash value accumulations, dividends may be applied or distributed in a variety of ways. One common dividend option is buying one-year-term insurance, allowing a permanent policy to add some term insurance. (Yes, this is another "C" option.) Note: Dividends are not guaranteed and are declared annually by the company's board of directors.

Paid-up additions (PUAs). Most permanent life insurance contracts are based on fixed level premium schedules that determine the guarantees and payment periods; some permanent policies may be designed to be paid-up in 10 years, others when the insured reaches age 100. Shorter payment periods not only result in fewer premiums, but also increase cash value accumulations. PUA provisions allow the policyholder some flexibility in increasing cash values and shortening the payment period.

One key point that doesn't seem to get much press: Personalized life insurance policies with features like those mentioned above aren't something you can obtain by

There are many workable formats for making life insurance a product with "C" options.

answering five health questions over the phone or over the internet. These policies require individual underwriting, because an insurance company wants a more in-depth picture of your health history and financial circumstances before offering a customized contract.

Since the general trend for most people is declining health as they get older, you are probably most insurable today. This makes a strong argument for applying for as much coverage as you can obtain as soon as possible (possibly this will be term insurance, with options to convert or restructure at a later date).

This brief overview of standard life insurance features should be enough to demonstrate that “C” options abound when it comes to life insurance. No matter what your current financial condition, it is obvious there are ways to design a life insurance plan that will meet both immediate needs and position life insurance as a long-term asset in your financial program.

CAN YOUR CURRENT LIFE INSURANCE PROGRAM COVER IMMEDIATE NEEDS AND BECOME A LONG-TERM FINANCIAL ASSET? ARE YOU USING YOUR “C” OPTIONS TO MAXIMUM ADVANTAGE?

(The next time someone asks you to decide between Ginger and MaryAnn, say “both.”)

THE CONFOUNDING TAX CONSEQUENCES OF COMPLEX FINANCIAL INSTRUMENTS



There’s a long-standing guideline for individual investors that says you should never buy a particular financial instrument purely for its tax-favored status – the underlying investment opportunity needs to make sense apart from its tax treatment. However, this

does not mean you can ignore the tax consequences when you evaluate a potential investment, because taxes can significantly impact overall returns. As more sophisticated investment vehicles have become available to a larger segment of individual investors, this issue has grown in importance.

A June 25, 2011, article from the *Wall Street Journal* titled “Extreme Tax Frustration” detailed some of the new and often unanticipated tax issues arising from exchange-traded funds that include commodities in their portfolios. An exchange-traded fund (ETF) is a security that tracks an index, a commodity or a basket of assets like an index fund, but trades like a stock on an exchange.

Some investors find that ETFs can be an effective way to invest in specific market sectors, with the attraction of portfolio diversification similar to mutual funds or other

pooled investments. However, depending on the types of investments held by an ETF, how these investments are titled, and how profits are distributed, the tax treatment can be dramatically different. Here is an example from the *WSJ* article:

Holders of gold stocks in a mutual fund would pay tax on long-term capital gains (those held longer than a year) of 15%. In contrast, shareholders of gold held in an ETF would be taxed at one’s marginal income tax rate, such as 28%, because the ETF is considered to have direct ownership of gold, and all profits are passed through the fund directly to shareholders as regular income.

Since many ETFs are structured as partnerships, this tax information is not reported to shareholders on a simple Form 1099, but instead on a Schedule K-1, which details the ETF’s income, deductions, credits, etc., and the percentage of profit or loss apportioned to the shareholder/partner. K-1s may be lengthy and complex, which adds significant cost to professional tax return preparation, as well as increasing the possibility of mistakes.

The prospect of higher tax rates and increased return preparation costs that may accompany the purchase of shares in some ETFs should certainly be among the issues considered by individual investors. As Laura Sanders wrote in the *WSJ* article, “The old adage ‘know what you own’ may not be enough. You also need to know what you’ll owe.”

But what about financial vehicles in which you aren’t sure of the tax consequences?

A “structured product” is the generic term for sophisticated financial instruments that feature investments whose performance is in some way guaranteed or completed by linking it to a pre-determined index or other security.

A “reverse convertible” is an example of a structured product, popular with some investors because of its potential for high yields. Here is a brief description of a reverse convertible, provided by FINRA, the Financial Industry Regulatory Authority, the regulatory agency that protects investors:

“A reverse convertible is a structured product that generally consists of a high-yield, short-term note of the issuer that is linked to the performance of an unrelated reference asset—often a single stock but sometimes a basket of stocks, an index or some other asset. The product works like a package of financial instruments that typically has two components:

- **a debt instrument (usually a note and often called the ‘wrapper’) that pays an above-market coupon (on a monthly or quarterly basis); and**
- **a derivative, in the form of a put option, that gives the issuer the right to repay principal to the investor in the form of a set amount of the underlying asset, rather than cash, if the price of the underlying asset dips below a predetermined price (often referred to as the “knock-in” level).”**

Sounds complicated, doesn’t it? That’s because structured products **are** complicated. But what’s even more confounding is FINRA’s commentary on the tax treatment of these financial instruments, from the Authority’s website (www.finra.org), updated on July 29, 2011,...

“The tax treatment of reverse convertibles is complicated and uncertain. Investors should consult with their tax advisors and read the tax risk disclosures in their prospectuses and other offering documents. Although these documents typically provide instructions on how investors should treat reverse convertibles on their tax returns, there is no guarantee that the IRS or a court would agree with that tax treatment. Little guidance in the way of court decisions or published IRS rulings has been issued on this topic. When considering the tax consequences of any investment, you may want to consult with a tax advisor.”

Note that FINRA is not questioning the integrity of structured products in general or reverse convertibles in particular. The performance of these products will vary greatly depending on their structure and investment specifics, but in general, structured products are legitimate financial instruments that may provide real financial benefits to consumers. The challenge is that the complexity of the product leads to uncertainties as to their proper tax treatment.

- **DO YOU KNOW WHAT YOU OWE AS A RESULT OF YOUR INVESTMENTS?**
- **INCLUDING TAXES, ARE YOU ABLE TO CALCULATE THE TRUE COST AND REAL RETURN OF YOUR FINANCIAL DECISIONS?**



THE ECONOMIC COST OF CARING FOR ELDERLY PARENTS

Want to forecast the future? Look for the demographics. They are huge indicators of long-term trends, and once in place, they tend to change very slowly. In developed countries, a predominant demographic trend is the combination of falling birthrates and aging populations. These two trends are

already in place, and the impact of these factors is inexorably working to change social and financial paradigms.

One of these areas of predictable change is the increasing number of children caring for elderly parents. As the combination of longer life expectancies and declining populations puts a greater strain on government-sponsored social safety-net programs, the default response will be placing a greater burden on children to care for their parents.

This change is not only foreseeable, but already gaining momentum. Data compiled by the National Alliance for Caregiving from the *U.S. Health and Retirement Study* is telling. Look at the differences between 1994 and 2008:

Percentage of men and women providing care for an aging parent:

	<u>1994</u>	<u>2008</u>
Men	3%	17%
Women	9%	28%

When almost 3 in 10 women are caring for an aging parent, it is a significant statistical trend. And the statistics also show clear correlations to changing social and financial dynamics.

Citing the same report, a June 14, 2011, *Wall Street Journal* article by Kelly Greene (“Toll of Caring for Elderly Increases”) notes that “the steep rise in people caring for elderly parents is taking a toll on the health and finances of many baby boomers.”

Among the workers over age 50, those who work and provide care for a parent at the same time are more likely to experience poor health, stress, depression and chronic disease. The report indicates these health problems are principally “a result of their focus on caring for others.”

One of the prominent sources of stress is financial cost to children when they become caregivers. A June, 2011 report, *Study of Caregiving Costs to Working Caregivers*, by MetLife’s Mature Market Institute, put this cost at over \$300,000 per person over age 50 if they are taking care of elder family members. This number reflects lost wages, pensions, and Social Security benefits over their lifetime, due primarily to a reduction in working hours, or leaving the work force entirely early to care for a parent.

As the numbers above indicate, there is a disparity between men and women as to who is most likely to be a caregiver. The Metlife study found that daughters were more likely to provide basic care while sons were more likely to give financial assistance.

Since they are often the ones providing day-to-day hands-on assistance, women are also the ones who are more likely to leave the workforce, and experience the greatest financial loss. The study broke down the financial losses as follows:

\$142,693	in lost wages
\$131,351	lost in Social Security
\$50,000	lost in pension benefits or matching contributions to defined-benefit plans.
\$324,044	Total

It’s important to note that these numbers are simple aggregates. They don’t factor the accompanying lost opportunity cost (LOC) that results. For example, what would the \$50,000 lost in pension benefits or matching contributions be worth after being invested for 15 or 20 years? The number and time period used to calculate the LOC is arbitrary, but even a conservative factor could easily forecast a financial loss approaching \$1 million.

Appropriate Responses

The math of taking caring of an aging parent looks ugly. But when it comes to family, financial sacrifice isn’t going to keep most children from doing the responsible and loving thing by caring for their parents. And the social value of maintaining these family ties far outweighs most financial considerations; placing the full responsibility for eldercare on strangers isn’t usually the best for children or parents. But that doesn’t mean parents or their children should ignore the financial consequences. Good financial decisions can improve many caregiving situations.

For parents who recognize either the likelihood or desirability of having their children be caregivers, any preparation will be helpful. This often starts with simply

organizing your financial affairs, then educating your children about your wishes and available assets. For some, this preparation might include rethinking Long-Term Care insurance, or redirecting current savings allocations.

We live in a mobile society, but proximity is a critical issue in caregiving. It's hard to be a personal caregiver for Dad when he lives in Florida and you live in Illinois. One of the greatest financial upheavals in caring for an elderly parent can be determining where it will take place. Will her daughter leave her job to come live with Mom? Or will Mom move and live with her daughter (and family)? Selling a house, leaving a job, putting an addition on an existing home – these are big financial decisions. If such a move is on your horizon, it might affect your saving priorities and accumulation strategies.

The rising trend of adult children caring for aging parents almost requires a multi-generational approach to financial decision-making – for parents and their children. In many ways, the necessity to integrate the financial objectives of several families that share common bonds can result in greater benefits for all, as the whole performs better than the sum of the parts. Although there are certainly costs associated with the decision to care for aging parents, there may also be significant opportunities.

- **AS A PARENT OR A CHILD, IS CAREGIVING IN YOUR FUTURE?**
- **WOULDN'T NOW BE A GREAT TIME TO SEE HOW INTER-GENERATIONAL STRATEGIES COULD HELP?**

GETTING ORGANIZED: Essential Documents to Store in One File Cabinet

Working from a list that appeared in a Saturday, July 2, 2011, *Wall Street Journal* article, here are essential personal and financial documents that should be readily accessible by you or your heirs in an eldercare situation. Your personal circumstances might not require having every item listed here, but the categories reflect the range of issues relevant to caring for an aging parent. Consolidating and organizing this information is not only a great benefit to you while you're living, it is also invaluable for your heirs.

By the way:

While having original documents and physical copies collected in one file cabinet is a fundamental of good financial organization, maintaining an electronic back-up file, such as the online data storage programs offered by many financial institutions, is a superb secondary location for the same documents. Check with one of your financial professionals to see if they offer this service.

Marriage and Divorce:

- Marriage license(s)
- Divorce papers

Health Care History and Instructions:

- Personal and family medical histories
- Durable health-care power of attorney
- Authorization to release health-care information
- Living Will
- Do-not-resuscitate instructions

Proof of ownership:

- Housing, land and cemetery deeds
- Escrow mortgage accounts
- Proof of loans made and debts owed
- Vehicle titles
- Stock certificates, savings bonds & brokerage accounts
- Partnership and corporate operating agreements
- Tax returns

Life insurance and retirement:

- Life insurance policies
- Individual retirement accounts
- 401(k) accounts
- Pension documents
- Annuity contracts

Bank Accounts:

- List of bank accounts
- List of all user names and passwords
- List of safe-deposit boxes

The Essentials:

- Will
- Letters of instruction
- Trust documents

FROM 107 TO 1,124 IN 32 YEARS. *Should you be impressed?*

The following factoid was part of the August 22, 2011, edition of "By the Numbers," an online business news digest:

On August 13, 1979 (i.e., 32 years ago), *BusinessWeek's* cover story was titled "The Death of Equities." The S&P 500 closed at 107 on 8/13/79. The index closed at 1,124 on 8/19/11 (source: *BusinessWeek*).

Some interesting facts, yes? But how should we interpret them? Here's a possible response: Left for dead 32 years ago, the stock market has proven a resilient and profitable investment over the long run. Another implication might be that just as the pessimists were wrong three decades ago, today's stock market pessimists could be wrong as well. It's pretty clear, isn't it?

Well, sort of. The factoid above was just three short sentences. It is concise, and after all, growing from just above 100 to over 1,100 represents substantial growth, doesn't it? Maybe there's more to the story.

For example...if you do the math, the growth of 107 to 1,124 over 32 years works out to an average annual increase of approximately 7.6%. While that number isn't bad, it is probably not what many would consider a "substantial" above-average long-term rate of return.

If those calculations diminish the factoid's impact a bit, an assessment of the S&P's performance might be even less enthusiastic when some other historical details are brought to light. Using an interactive website, it was possible to create a mountain chart illustration specifically reflecting the index's 32-year performance from August 1979 to August 2011. See the graph below.

Several things jump out. The S&P's price today is lower than it was in November 2000, which means the average annual return for the past decade has been slightly negative. And although the 10-year numbers are flat, the degree of fluctuation during the decade has been significant. Looking at the long-term history, the index appears to record two distinct periods: The first is characterized by a steady upward climb above 1,400 over 20 years, while the second era is marked by steep peaks and valleys.

As you dig deeper into the numbers, has your assessment of the initial 107-to-1,124 statement changed? Probably. But besides changing your perspective on past performance, how would you use this information to make a decision about future investment opportunities in the S&P? Is the future going to be one of continued volatility or is the index about to enter another unique period of steady results? If so, is it possible that the next trend may be steadily downward? Those are questions that probably can't be answered without conducting even further research.

The Information Age makes a sea of facts readily available to everyone. The crucial factor in making informed financial decisions isn't just getting the information. Rather, it is knowing how to evaluate the data, and determine which facts are relevant to your situation.

- WHO HELPS YOU EVALUATE THE FINANCIAL FACTS OF YOUR LIFE?
- DO YOU KNOW (AND UNDERSTAND) THE CRITERIA?
- IS IT TIME FOR ANOTHER ASSESSMENT?



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