

# TOPICS IN WELFARE BENEFIT FUNDING

**MetLife**

## LOOKING BEYOND HEALTH CARE: FUNDING RETIREE LIFE INSURANCE

The Patient Protection and Affordable Care Act (PPACA) has brought with it the need for employers of all sizes and across all walks of the corporate landscape to focus significant resources on understanding its requirements and determining how best to apply it to employee benefits for not only their active employees, but also their retirees. As a result of the PPACA, employers have focused on costs and platform delivery solutions for post-retirement medical benefits.

Some employers have made the decision to either discontinue these medical benefits to their retirees or provide them through private exchanges. This often has the effect of limiting their liability and transferring the plan administration to a third party. Similarly, it is prudent for employers to consider other important retiree benefits, specifically employer-provided group term life insurance as part of their overall strategy. Retiree term life insurance is fundable on a tax-advantaged basis.<sup>1</sup>

This paper highlights group term life insurance as an important element of a retiree's overall financial security and its importance as part of an employer's benefits plan. It also describes various funding strategies available to employers and benefit plan sponsors for continuing this benefit, while managing its cost and administrative impact on their companies.

### RETIREE LIFE INSURANCE: A KEY COMPONENT OF RETIREMENT READINESS

In a recent Towers Watson Study, 78% of the 457 U.S. employers surveyed say that retirement readiness has become a top issue for their employees, and 82% believe retirement security will become a more important issue for employees in the next three years.<sup>2</sup> This is due to the fact that many employees, including those on the cusp of retirement, are not adequately prepared for retirement.

Inadequate retirement savings and personal debt can make it more difficult for retirees to pay for their ongoing expenses. Today, more than half of pre-retirees (55%) are in only “fair” or “poor” shape to “completely cover essential expenses like housing, health care, and food in their golden years,” according Fidelity’s Retirement Preparedness Measure.<sup>3</sup>

The situation is even more alarming considering the impact of retiree debt on an individual’s retirement readiness and their family’s financial security in the event of their death. According to the Employee Benefit Research Institute, 9% of retirees describe their debt situation as a major problem.<sup>4</sup>

On top of debt, funeral costs can add to a family’s financial burden in the event of a retiree’s death. In 2012, the national median cost of a funeral was \$7,045.<sup>5</sup> This cost is increasing each year, and may be significantly higher in certain regions or cities. Retiree life insurance can help offset this financial burden.

### **THE VALUE OF EMPLOYER-PROVIDED RETIREMENT BENEFITS**

The value of employee benefits—including retirement benefits—has a direct impact on employee recruitment and retention. According to MetLife’s *12th Annual U.S. Employee Benefit Trends Study*, 40% of workers say they are worried their “employer will reduce benefits” at a time that an equal percentage say they are looking to their employer for “more help in achieving financial security through employee benefits.”<sup>6</sup>

With regard to life insurance specifically, 53% of employees are very concerned about financial security for their families in the event of their premature death.<sup>7</sup> This is not surprising considering that more than half of employers acknowledge that most employees do not have adequate life insurance coverage. In fact, many employees rely on the group life insurance provided by their employer while they are working, and may not have considered the cost of replacing this coverage after they retire. Because of the high cost of life insurance at older ages, having to replace this coverage can significantly impact a retiree’s monthly retirement income.

### **PROVIDING RETIREE LIFE INSURANCE IS A LONG-HELD TRADITION**

Corporations have been providing retiree life insurance for many years, and surveys indicate that many continue to do so. Since most life insurance rates are dependent upon the age and health of the individual at the time the policy is purchased, coverage may become too expensive or impossible to obtain in retirement. Some retirees may not even qualify due to advanced age or medical reasons. If coverage is unavailable, retirees will be left without this important component of their financial safety net.

Employer-paid retiree life insurance may be one of the least expensive retirement benefits to offer. Employers can use their group buying power to secure competitive rates, and employees can receive guaranteed issue coverage. Plus, most employer-provided retiree life insurance schedules are less than amounts provided to active employees. Often, the coverage is simply provided to cover final expenses.

Additionally, employers can pre-fund the liability or future costs associated with retiree life insurance on a tax-favored basis to potentially reduce or control long-term costs.<sup>8</sup>

#### DETERMINING HOW TO BEST MANAGE THESE BENEFITS

An important question employers need to address is how best to manage this important benefit. Current accounting rules treat post-retirement benefits (including employer-paid group term retiree life insurance) as a form of deferred compensation that creates a liability that must be accounted for on corporate financial statements.<sup>9</sup> This suggests that employers need to plan or fund for these liabilities and future costs. However, many employers also need or want to find ways to reduce these expenses and perhaps offset or remove these liabilities from their corporate balance sheets.

Unfortunately, many companies haven't planned to address these liabilities. They simply pay for retiree life coverage monthly, as they do for active employees under a **Pay-as-You-Go Strategy**. Under this approach, employers retain mortality, investment and expense risks. In other words, the employer is exposed to the risk of increasing costs or premium rates on retiree group term life coverage. However, there are additional ways to manage or fund these risks in a cost-effective manner while strengthening a company's financial statements and increasing corporate financial flexibility. These strategies or alternatives include the following:

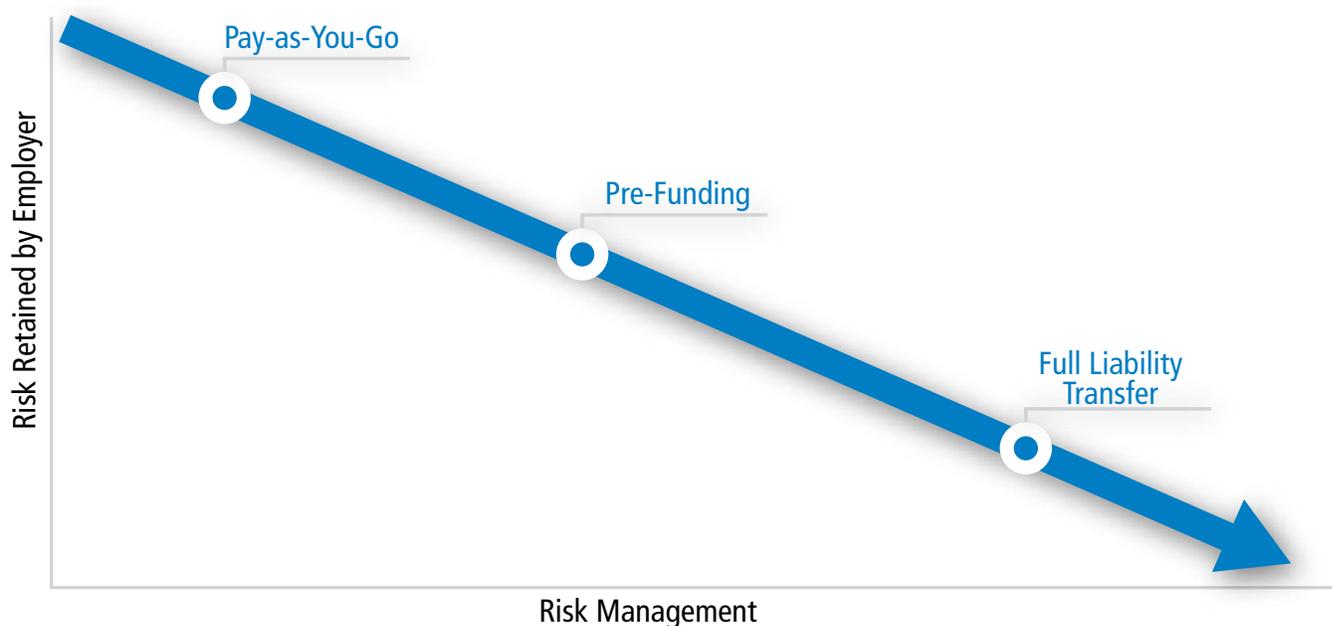
With a **Pre-funding Strategy**, also known as retiree life funding, the risk of increasing costs is retained by the employer, but they are able to fund future retiree life costs on a tax-advantaged basis, up to tax code funding limits.<sup>10</sup> Funding within a retired lives reserve tied to a group term life insurance policy is an easy, convenient and flexible way for employers to pre-fund the cost of retiree life insurance for both current and future retirees.

This strategy incorporates a retired lives reserve wherein the employer makes tax-deductible contributions based on their specific liability. The reserve grows tax-free (up to tax code funding limits) and the assets in the reserve are used to pay monthly group term retiree life insurance premiums. Additionally, the assets held in the reserve offset the retiree life insurance liability on the corporate balance sheet. Nevertheless, pre-funding may not be a good fit if retiree life insurance volumes are small, the employee population is subject to high turnover, the company has cash flow constraints, and/or if the company is unable to benefit from its tax and accounting advantages.

With a **Full Liability Transfer**, also known as a retiree life buyout, employers can transfer their post-retirement life insurance liability to an insurer, removing it from the balance sheet entirely. This is often an appropriate solution if the retiree plan is closed to new entrants. The buyout transfers or eliminates exposure on the covered retiree population for mortality, investment and expense risk, and thereby relieves the employer of potential future premium rate and cost increases associated with the retiree life insurance plan.

Typically, a retiree life buyout may be accomplished as a single lump sum payment, but installment payment options are often available. In pricing the buyout, the insurer will generally discount future retiree claims based on current market interest rates. Consequently, the price may be significant on an older retiree population, and can fluctuate daily with changes in market interest rates. Moreover, as retirees age, the price for the buyout may increase since the time horizon available to pay the claim is diminished. Therefore, it may be prudent for the employer to take action sooner—rather than waiting—if corporate cash is available.

Coincident with the liability transfer, plan administration is also transferred to the insurer. This relieves the employer of recordkeeping expenses on the specific named group of retirees, and may be particularly valuable to an already overstretched benefits department.



Determining the right strategy for managing retiree life insurance liabilities will vary from employer to employer. The available solutions enable employers to efficiently manage these liabilities and mitigate risk. However, they also require a commitment of additional budget dollars up front, which may represent several years of retiree group term insurance premiums or more, particularly in the case of a buyout. Therefore, any decision to proceed may require the involvement of an employer's corporate finance and accounting personnel. On the other hand, if corporate cash is available, these decision makers are often supportive because of the potential benefits to company financials.

For benefits decision makers, these strategies may enhance the availability of funds to pay for future retiree life premiums by offering financial flexibility, predictability and budgeting around premium costs. Before making a final decision about which funding strategy to employ, employers are encouraged to discuss funding alternatives with their benefits, accounting and tax advisors.

> For more information, e-mail us at: [PostRetirementBenefits@MetLife.com](mailto:PostRetirementBenefits@MetLife.com)

<sup>1</sup> To enjoy the tax advantages associated with this product, pre-funding must be within tax code limits enacted by the Deficit Reduction Act of 1984 (or DEFRA limits), which generally limits pre-funding for post-retirement group term life insurance to a \$50,000 maximum coverage amount over the working lives of covered employees, and actuarially determined on a level basis. Any discussion of taxes is for general informational purposes only and does not purport to be complete or cover every situation. MetLife, its agents and representatives may not give legal, tax or accounting advice and this document should not be construed as such. Clients should confer with their qualified legal, tax and accounting advisors as appropriate.

<sup>2</sup> Towers Watson, 2014 North American Defined Contribution Plan Sponsor Survey, November 2014. The companies surveyed sponsor 401(k) plans or 403(b) plans, represent a range of industry sectors, and have more than 1,000 employees and \$10 million or more in assets.

<sup>3</sup> Fidelity's Retirement Preparedness Measure score provides a single retirement readiness measure that enables easy comparisons across generations and income levels. The score is based on real worker data from Fidelity's 2013 Retirement Savings Assessment, an extensive survey of more than 2,200 households that is then analyzed using Fidelity's financial modeling engine.

<sup>4</sup> Employee Benefit Research Institute and Mathew Greenwald & Associates, *2015 Retirement Confidence Survey*, April 2015.

<sup>5</sup> National Funeral Directors Association, March 9, 2015.

<sup>6</sup> MetLife, *12th Annual U.S. Employee Benefit Trends Study*, June 2014.

<sup>7</sup> MetLife, *Study of the Financial Impact of Premature Death*, September 2009.

<sup>8</sup> Neither MetLife nor its representatives provide tax or accounting advice. Tax law and accounting rules are subject to interpretation and change. Tax and accounting results and the appropriateness of any product for any specific company may vary depending on the facts and circumstances. Employers should consult with, and rely upon, their own accounting advisors.

<sup>9</sup> Financial Accounting Standards Board, *Statement of Financial Accounting Standards No. 106*, December 1990.

<sup>10</sup> See endnote 1.

1506-108749 CS  
© 2015 METLIFE, INC.  
L0615425353[exp0617][All States][DC]

# MetLife

**Metropolitan Life Insurance Company**  
200 Park Avenue  
New York, NY 10166  
[www.metlife.com/institutionalretirement](http://www.metlife.com/institutionalretirement)