Advanced Markets
smooth sailing on uncertain waters

What is Smooth Sailing?

AXA’s Smooth Sailing on Uncertain Waters helps show how cash value life insurance can provide clients and their families peace of mind as part of an overall financial plan, both before and after retirement.

• During a client’s working years, the life insurance death benefit offers a client’s family a means to help complete some or all of their retirement goals in the event a breadwinner dies prematurely.

• During retirement, the life insurance cash value may offer clients a safety-net to draw upon in the event their traditional retirement assets suffer losses.

By combining life insurance cash values and traditional retirement assets, a client using the Smooth Sailing approach has an opportunity to preserve, and perhaps grow, their retirement account. Smooth Sailing allows a client to turn off withdrawals from their traditional retirement assets during market loss years. During those years, a client can turn to their life insurance cash values as a source of funds, thereby avoiding selling into losses and exacerbating market losses in their retirement portfolio.

AXA offers a wide array of support for the Smooth Sailing on Uncertain Waters concept. These include a detailed client marketing piece, a shorter producer focused overview and several PowerPoint presentations. This Frequently Asked Questions piece helps address some of the commonly asked questions on this approach to retirement planning aided by life insurance.

Isn’t Smooth Sailing just another way to show life insurance cash values supplementing retirement income?

Yes and no. In most presentations using cash value life insurance to help supplement retirement, policies are maximum-funded relative to the death benefit, during a client’s working years, to provide the maximum retirement income for the client. This is typically illustrated to show 20 years of income starting at age 65. In this approach the annual policy distributions (via loans or withdrawals) help supplement, but are a core component of, a client’s annual retirement income. This is the approach most carriers promote; AXA competes very well in this area with strong 20-year monthly income distributed from maximum funded life policies. We also offer a range of marketing support for this planning approach, including concepts called the Roth IRA Alternative, Private Reserve, Dialing Your Tax Bracket and general Supplemental Income materials.

1 Loans and withdrawals reduce the policy’s cash value and death benefit and increase the chance that the policy may lapse. If the policy lapses, terminates, is surrendered or becomes a Modified Endowment Contract, the loan balance at such time would generally be viewed as distributed and taxable under the general rules for distributions of policy cash values.
Smooth Sailing differs from the traditional accumulation sale in that clients don’t need to maximum fund their life insurance policy for annual retirement income. Instead, they need to adequately fund their life insurance policy to generate cash values that can be selectively accessed during retirement. Under the Smooth Sailing approach, a client draws on the policy cash values via withdrawals or loans only in years after there is a down stock market.\(^2\)

| Tom’s Retirement Account Balance With and Without Life Insurance Planning & Smooth Sailing |
|---------------------------------|---------------------------------|---------------------------------|---------------------------------|
| **Starting Balance** | **Balance in 20 Years Without Smooth Sailing** | **Balance in 20 Years With Smooth Sailing** | **Number of Down Market Years Funds are Drawn from Life Insurance** |
| $1,000,000 | $444,791 | $3,587,386 | 5 |

In short – Using the Smooth Sailing approach, policy cash values help a client avoid selling during loss years and exacerbating the loss. The policy cash values offer a client a potential source of funds they can access on an as needed basis to help smooth out one’s drawing down on retirement assets during the retirement years.

**Does Indexed Universal Life (IUL) offer any advantage with the Smooth Sailing concept?**

In general, cash value accumulation products can help a client accumulate funds during their working years while also offering death benefit protection for a client’s family. This helps protect the family in the event a breadwinner passes away before they’ve fully accumulated funds for retirement. We have a range of competitive cash value accumulation products, including a VUL product (IL Optimizer® III) and a cash value focused death benefit product (BrightLife® Protect). However, Smooth Sailing is designed for clients who are concerned about market losses and want some protection against those loss years. In this instance, Indexed Universal Life (IUL) may be attractive and our BrightLife® Grow product is an IUL designed to potentially generate strong cash values and retirement income while still offering death benefit protection for a client’s family.

With BrightLife® Grow, clients have the potential to receive some upside potential, based on the caps offered and the market indices selected by the client. BrightLife® Grow also offers the ability to lock in the prior policy crediting through the use of a floor during loss years. This floor (zero percent) helps protect accumulated cash values during down market years, as clients cannot see negative returns based solely on a down market.

It is important to keep in mind that not all IUL products are alike. Many IUL products offer high caps that illustrate well because most illustrations show the same crediting rate year over year. However, often those products showing high crediting rates also carry high internal charges. In down market years, the crediting that a client thought was protected by a floor might be eroded by these charges.

BrightLife® Grow product may be particularly appropriate for clients who are interested in the Smooth Sailing approach as a way to provide a safety net in retirement. BrightLife® Grow is among the lowest cost IUL products offered. These lower charges allow a client to preserve more of what they’ve accumulated. This fits well with the Smooth Sailing concept where a client wants to preserve assets in down market years.

BrightLife® Grow also doesn’t put clients at potential risk by coupling the access to policy cash values with variable or participating loans.

**The Smooth Sailing marketing materials feature the market performance from 1973 to 1993. Why did AXA pick those years? Can you show the Smooth Sailing concept using different years?**

AXA was very particular in showing 1973-1993, for the reasons described below. In the client white paper, we also show how a client’s retirement income would have performed under a different cross section of market performance (from 1990 – 2010) to contrast the differences that market performance can have on a client’s retirement fund.
First, we selected a 20-year time period because it was a reasonably rounded period of time. Under the 2008 VBT Life Expectancy tables, a 65-year-old client has a life expectancy of approximately 22-23 years (ages 87-88). The same 20-year period shown in Smooth Sailing carries that client from age 65 to age 85, approximately that same timeframe, but rounded into even decades.

Secondly, if you review the performance of the S&P® 500®, in any given twenty year period there are typically 4-6 years when the market suffers losses. In some years the losses can be significant, while others may be low single digit loss years. If a client faces losses during their early retirement, the losses can have a significant impact on the long-term performance of their retirement funds. By drawing on the life insurance cash values in the year following those down market years, a client can help mitigate the drain on their traditional retirement assets. Of course, past performance is not indicative of future results and this performance cannot be guaranteed. Clients may not invest directly in the S&P 500® Index.

AXA selected 1973-1993 because it was reasonably representative of a 20-year time period beginning with losses. The Smooth Sailing approach is intended to protect clients from loss years in their retirement portfolio; these losses can be particularly devastating if they occur early in retirement. The 1973-1993 period has five years of losses (a reasonable middle ground). Although these years capture the general up market years seen in the 1980s, they also began with losses in the first two years. There was a similar loss period in the mid-1960s, but that timeframe had six periods of losses over 20 years and didn’t temper those losses by capturing the up market in the 1980s. Instead, it centered on the years of market and economic stagnation of the 1970s. As such, the higher number of loss years and the down market in the 1970s exaggerated the losses. Using 1973-1993 offered a more balanced approach.

To further balance the discussion, in the client piece we also showed how the Smooth Sailing approach might look using the timeframe from 1990-2010. That timeframe is, in many ways, the mirror image of 1973-1993. The 1990s were, arguably, one of the best performing decades. They were followed by the 2000s, arguably one of the worst performing decades in recent memory. However, a client retiring in the early 1990s would not have experienced down market years early in retirement so they would not have started retirement with early losses. In effect, their retirement assets increase, even with steady withdrawals because there are few early years of losses. This is despite the underperforming market in the later years of the timeframe.

Keep in mind, slicing different iterations of 20 year periods misses the point of Smooth Sailing. The idea is to have cash value life insurance protection during a client’s working years. That cash value then provides additional options and protections during a client’s retirement years, particularly if a client suffers losses in those years. Because you cannot predict how the market will actually perform, the Smooth Sailing materials show a good 20-year timeframe (1990-2010) as well as a bad timeframe (1973-1993) to compare and contrast. Showing each different 20 year iteration would be redundant.

AXA is frequently asked how this might look with the losses in the 2000s, coming from the dot.com bust and the 2008 market collapse. While that will be of great interest to many, there are still several years to go before we complete the 20-year track record from 2000-2020.

In the Smooth Sailing materials, you are showing a client drawing down 7% of their retirement assets. Isn’t this too aggressive a rate of withdrawal? Shouldn’t they withdraw a lower amount, such as 4% of their traditional retirement assets?

The 4% drawdown rate on retirement assets is strongly embraced by many in the planning community. However, it may not fit all clients in all instances. Also, the origins of the 4% drawdown rate are based on an article from the 1990s that focused on segments of the markets over decades to determine the safest rate of interest. As discussed below, the exact circumstances that produced the 4% drawdown number may not fit all clients.

In the case of many clients, they may not have the option to only draw down at a 4% rate and meet their standard of living. Any number of factors could contribute to this, including a high standard of living and a low savings rate. In many instances, a client may have a reasonable standard of living, a reasonable source of fixed retirement income (Social Security, a pension, etc.) but may still not have assets to maintain his standard of living without accessing more than 4% each year.
In 1996, William P. Bengen wrote an article for the *Journal of Financial Planning,* that has been widely adopted over the years and recognized as the cornerstone of the 4% rule. In that article, Bengen looked at historic market performance over extended periods of time, using different bond/stock portfolio models and making assumptions for inflation. He concluded that if a portfolio had a high stock ratio (75% in his high stock ratio models), and should historical performance be repeated in a worst sequence of returns, a 4% withdrawal rate would sustain the portfolio for over 30 years. Such would not be the case at a 5% withdrawal rate under the same circumstances. However, it is important to note that in Bengen’s model he was assuming a worst case scenario for the 4% model. Bengen was not recommending any specific withdrawal rate, but instead considering a withdrawal rate that was based on a client’s overall assets and what he believed might be a reasonable return over a period of time.

**Why is AXA showing a lower amount coming out the life insurance policy cash values than the client might need on an annual basis?**

As shown in the chart below, different asset types offer different characteristics. These can range from how funds accumulate within a given product, their taxation when accessing values, creditor protection, etc. Which assets are appropriate for a client's retirement will vary widely based on their individual planning needs, the available retirement accumulation options, risk tolerance, etc.

In the case of life insurance, withdrawals and policy loans from a properly structured non-MEC (Modified Endowment Contract) life insurance policy can be received income tax free. This offers the client the ability to receive policy income without the erosion faced by taxable assets. As a result, clients in a 28% tax bracket can receive the pre-tax equivalent of $70,000 (year one income) by only taking out $50,000 from their life insurance policy:

\[
\frac{50,000}{1.28} = 69,445
\]

In our Smooth Sailing pieces, as inflation increases a client’s income need over the 20-year retirement period, we’ve shown larger amounts coming out of a policy to roughly match that income need.

<table>
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<th>Acquisition</th>
<th><strong>Qualified Plans/IRA</strong></th>
<th><strong>Equities</strong></th>
<th><strong>Tax-Free Bonds</strong></th>
<th><strong>Annuities</strong></th>
<th><strong>Life Insurance</strong></th>
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<td>NONE</td>
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<td>Income (dividends and/or interest)</td>
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<tr>
<td></td>
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<tr>
<td></td>
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<tr>
<td>Distribution</td>
<td>Income Tax on Annual Income</td>
<td>Account Taxable (prior to age 59½, 10% penalty may apply)</td>
<td>Gain Taxable</td>
<td>Gain Taxable</td>
<td>Account Taxable (prior to age 59½, 10% penalty may apply)</td>
</tr>
<tr>
<td></td>
<td>At Death, Included in Taxable Estate</td>
<td>Included Max Rate 40%</td>
<td>Included Max Rate 40%</td>
<td>Included Max Rate 40%</td>
<td>Included Max Rate 40%</td>
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<td>No</td>
<td>No</td>
<td>State Law Controls</td>
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</tbody>
</table>

4 Does not include Roth IRAs.
5 Dividends already taxed excluded.
6 Withdrawals other than loans and in excess of basis, taxable.
7 While non-MEC policy remains in force, loans remain tax-free. Termination may trigger tax.
**Why are you not showing Required Minimum Distributions (RMDs) out of a client's retirement assets in the down market years?**

Most clients will have some or all of their retirement funds in qualified retirement plans, 401(k)s, 403(b)s or IRAs that mandate required minimum distributions (RMDs) — usually beginning the year following a client’s 70½ birthday. As a result, a client won’t be able to turn off all withdrawals out of their retirement accounts. Also keep in mind, a client can distribute assets from their IRA in kind, thus maintaining their existing position. The client would still have to pay income tax on the value of the distributed assets.

The Smooth Sailing presentation and materials are intended to show a concept — what will happen if a client can eliminate drawing down on assets at the time of a loss. The core focus of the Smooth Sailing concept was never intended to go into specifics of various asset types and their taxation — beyond showing how life insurance could help. Building in a chart that also showed RMDs would have blurred the point being made in the Smooth Sailing client white paper. Additionally, every client will be different. Some may have all of their assets in accounts that mandate RMDs. Other clients may have little or no assets in these accounts. Moreover, how much clients will have in these qualified accounts will vary widely, particularly with the advent of Roth IRAs and Roth 401(k) accounts.

Even though most clients will have at least some assets that require RMDs, in most instances these required distributions can be kept low in the early years following retirement. Keep these items in mind:

- Assuming a client retires at age 65, the RMDs won’t be required until the year following a client’s age 70½. That would likely be 6 years after the concept shown in the Smooth Sailing marketing items, and beyond the early years of retirement. In the Smooth Sailing marketing piece showing values for 1973-1993, RMDs won’t come into play until the client would have seen three of the five years of losses.
- Because of the way the RMD calculation works, the mandated withdrawals in the early years are low because the divisor offered by the Treasury and IRC Regulations to calculate RMDs is high. As a result, minimal dollars might need to come out of a retirement account in these early years.

Because of these two items, RMDs have some effect on the calculations shown in the Smooth Sailing marketing pieces, but the approach still offers the client a safety net. Assuming 100% of a client’s assets require RMDs, the overall impact of Smooth Sailing at a client’s age 85 would change from $3,587,386 to $3,228,356, but the effect of the Smooth Sailing approach is still applicable.

In effect, the difference in this specific example with and without RMDs is $359,040, or about a 10%.

**What would it look like if I took the same premium dollars and put them into something other than life insurance?**

AXA offers a great deal of support to show what a client might experience if they were to direct their premium dollars into a hypothetical portfolio, as opposed to life insurance. Work with your AXA representative and ask them to show you support concepts we offer called 1) Life Insurance as an Asset, or 2) Return on a Lifetime. Using these presentations, we are able to show a client how a life insurance death benefit can offer clients an additional facet to their overall wealth transfer strategy through a strong IRR at death.
However, the heart of this question misses the point of what Smooth Sailing is intended to do. Here the focus is on an accumulation life insurance product to help protect a client while also offering cash accumulation versus a death benefit. With the Smooth Sailing approach a client has:

- Life insurance protection during their working years.
- A tax deferred way in which to accumulate cash values, particularly if they have already maximized their traditional retirement accounts, such as IRAs and 401(k) accounts.
- Life insurance cash values that can be accessed in a tax-free manner.\(^1\)
- Protection against wide market fluctuations through use of a conservative low-cost IUL product.

Wouldn’t a client be better off buying term insurance and investing the difference?

Some might argue that term insurance is the most cost-efficient product during a client’s working years and that they would be better off simply investing the difference. Assuming a client is disciplined enough to invest the difference, they may still be better off with BrightLife® Grow. First, the cash values grow on a tax-deferred basis and can be accessed in a potentially tax-free manner. Moreover, by using an indexed UL policy, a client can capture some of the upside of the market while protecting gains against when market drops below zero. Moreover, BrightLife® Grow’s low charges also help preserve gains in low or zero crediting years. Finally, the life insurance cash values become an asset in a silo separate and distinct from traditional assets that are earmarked for retirement, so a client will know to focus on these assets only following down market years.

What is the best way to illustrate a life insurance policy for the Smooth Sailing concept?

This will vary widely from client to client, and will be based on their overall objectives, year by year cash flow and overall needs. In most instances, it will be easier for a client to budget an annual or monthly premium. In other instances, they may wish to direct a bonus or periodic cash infusion into their policy and an indexed universal life insurance policy will allow them the flexibility to do so.

In most instances, a client won’t need to maximum fund a policy, which is the traditional approach when using life insurance cash values to help supplement retirement. They could simply fund a policy to build reasonable cash values to act as a safety net in retirement.

How reasonable a cash value will depend on the client’s sentiment? Because clients will never know when losses will hit, focus on a worst case scenario. Generally, a worst case scenario would be 2-3 years of market losses at the outset of a client’s retirement, followed by a few other random years when one may need to draw on the policy values. Any policy design should have substantial enough premium payments relative to the face amount to be able to hold up beyond a client’s targeted life expectancy, or beyond. In modeling an illustration you may want to show some random years for withdrawals from the policy.

A final item concerns a client’s age when illustrating accumulation products. In general, these will illustrate best when a client is age 50-55 or younger. As a client approaches age 60, there will rarely be enough time to accumulate meaningful cash values even if the policy is showing maximum non-MEC funding. In those instances, a client will need to understand that they may need to defer accessing policy cash values until age 70 or later.

Why should I use Indexed Universal Life? Won’t this work equally well with Whole Life Insurance (WL)?

Whole Life, which often offers high dividends in the illustrations, will look great so far as building cash value, even guaranteed cash value. However, whole life insurance is often a difficult product from which to extract cash. Remember, cash withdrawals and loans are essential to the selected life insurance distributions from the life insurance policy, as an alternative to the main retirement silo after market down years. To match the flexibility offered by IUL, WL policies often require a much larger premium during the accumulation phase to produce similar distribution amounts during the distribution years.

Essentially whole life may not always offer as cost-effective or flexible method compared to UL or IUL policies.
Other Considerations:

• Withdrawal rates are subject to debate among planners. The withdrawal rate shown here may or may not be appropriate for your clients’ specific situation. In some instances, a lower withdrawal rate may be appropriate, in other instances this may be an appropriate withdrawal rate.

• If clients are able to actually achieve strong early year returns, they won’t have the same risk related to their retirement funds, but will have a life insurance death benefit and its cash values to help enhance their overall goals. This strategy is intended to address the concerns clients might see if they don’t receive strong early returns, as was the case in much of the 2000s.

• There is usually a surrender charge that will vary by type of policy. These charges usually run 15 years or longer and will affect the available amount clients have to withdraw or borrow from their policy at any given time. There are also cost of insurance and other policy charges that will impact the cash value.

• The strategy presented here is intended to reflect a broad concept and individual situations will be different. In certain cases, clients will not have complete flexibility with all assets.

• In many instances, IRA and qualified plan assets will require minimum distributions after age 70½. This will force assets out of retirement funds even in years following market losses.

• How much life insurance a client can purchase and the price they will pay will depend on medical and financial underwriting. Your clients’ results will vary based on their underwriting offer.

• To make this effective, client will need a long-term buy and hold strategy with a cash value life insurance policy.
The numbers represented here are based on a $1,000,000 starting balance in a retirement account. Growth is based on the S&P® 500 market performance from 1973-1993. See a separate question in this document as to why those years were selected. This assumes a drawdown rate of $70,000 per year in year one, indexed 1% annually for inflation. Loans and withdrawals reduce the policy's cash value and death benefit and increase the chance that the policy may lapse. If the policy lapses, terminates, is surrendered or becomes a modified endowment, the loan balance at such time would generally be viewed as distributed and taxable under the general rules for distributions of policy cash values.


This will vary by the type of plan, the client's age and entry into the plan.

This is also echoed in articles such as Updegrave, “How to Manage Your Retirement Withdrawals,” The Wall Street Journal, June 6, 2014. The author also recommends taking minimal withdrawals from retirement plans (subject to RMD requirements) in down market years.

Loans and partial withdrawals will decrease the death benefit and cash value of your life insurance policy and may be subject to policy limitations and income tax. In addition, loans and partial withdrawals may cause certain policy benefits or riders to become unavailable and may increase the chance your policy may lapse. If the policy lapses, is surrendered or becomes a MEC, the loan balance at such time would generally be viewed as distributed and taxable under the general rules for distribution of policy cash values.

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