Life Insurance:

The Swiss-Army Knife of Financial Products

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The ubiquitous Swiss-army knife has been around since the late 19th century and is just as much of a workhorse today as it was originally. In the 125 years since first introduced this multi-purpose tool has evolved from a simple pen knife with a screwdriver, reamer and can-opener tools to one that serves today's consumer with a USB stick, LED light, and digital clock.

Is there an equivalent product in the financial services arena? Just as the Swiss-army knife is more than a pen knife, life insurance is more than a conservative, single purpose financial product. It is the workhorse of financial professionals. Life insurance has evolved from what started as a widows and orphans fund to a set of products that provide death benefit protection and so much more. Carriers offer term and whole life products and additional choices like universal life, variable universal life and indexed universal life. Carrier consumer studies suggest professionals initially position life insurance as a protection product and quickly plant the "and so much more" idea. The examples shared here verify just how modern life insurance is.

Protection for family and loved ones

For many people, the primary purpose for life insurance is to provide financial freedom for the family after the loss of a husband, wife, mother or father. The death benefit from a life insurance often makes it possible for the family to remain in the family home, continue in the same schools, or attend college as planned. And while safeguarding the family is one way to use life insurance, there are so many more ways life insurance can provide financial security and a sense of certainty to loved ones. These are just a few other uses for life insurance to provide for one's family and loves ones:

- **Tax-free wealth transfer:** No other financial product that comes close to creating wealth the way life insurance does and without the tax expense of transferring other types of wealth from one generation to another. The death benefit of an insurance policy is usually distributed income tax free to the named beneficiaries. Individuals, organizations, schools, churches, alma maters can be a named beneficiary of a life insurance policy.

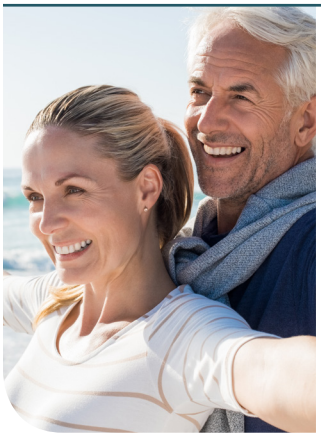
- **Providing for special needs children:** Parents with a special needs child fear for the future of the child when they are no longer here to provide care and financial support. Providing for a special needs child requires careful planning. For example, one eligibility criterion to receive federal assistance is an asset maximum. A Special Needs Trust can be funded with a life insurance policy and not be considered an asset of the dependent child. There is much to know about special needs planning that provides financial support without jeopardizing government assistance; it is wise to form a relationship with an attorney specializing in special needs arrangements.

- **Funding the cost of long-term care:** Clients who want to leave an inheritance for family members need to plan for the effects long-term care expenses may have on the value of the estate to be inherited. A life insurance policy with a long-term care rider offers financial assistance for long-term care expenses while simultaneously protects other financial assets, investments, retirement accounts from being depleted. If long-term care is not needed, the policy death benefit becomes another instrument for inheritance.

- **Paying for college and other large expenditures:** The cash value of a permanent policy can be accessed without a taxable event for any purpose. With proper planning, an advisor can help a client prepare for the expense of college tuition using a permanent policy. An indexed universal life or whole life can work well for the client whose objective is to accumulate cash value to be distributed later for something like college expenses or to supplement retirement income. Using life insurance to fund a college education offers access to accumulated cash value while providing the protection of a death benefit.

The long-term nature of life insurance, when benefits are accessed well into the future, requires that inflation factors should be considered when determining the amount of coverage and choosing the death benefit option. Selecting an increasing death benefit option helps protect against inflation. With Universal Life products, Option 2 or B, the death benefit increases as cash value accumulates. Depending on premium contributions, as the policy matures the death benefit will automatically grow to be significantly higher than the amount originally applied for.

Augmenting retirement income



Life insurance is often overlooked as a retirement asset despite the unique advantages permanent life insurance affords the retirement portfolio. However, the tax-advantages of life insurance, especially in retirement planning, can't be overstated. One of the benefits of a qualified retirement plan like 401(k)s is that earnings on the account value are tax-deferred. Permanent life insurance also benefits from tax-deferral as the cash value accumulates.

Life insurance has two additional attractive advantages:

1. Premium contributions to the policy are not subject to the IRS annual contribution maximums. Particularly for high-earners, limited qualified plan contributions lead to a smaller percentage of total income earmarked for retirement. A flexible premium policy like indexed universal life can accept a considerably larger annual contribution increasing the amount of annual contributions to a retirement asset while still benefiting from the tax-deferral. The premium contributions to the life insurance policy are not on a pre-tax basis as with a qualified plan.

2. Maybe the most significant advantage of including life insurance in the retirement plan is the unequaled benefit of tax-free access to cash value. If borrowed, policy cash values can be distributed as retirement income tax-free and are not counted as income for purposes of calculating income taxes on Social Security benefits. Summing up, including a permanent life insurance policy as a retirement asset:

   - Allows for larger annual contributions to a retirement account
   - Defers income tax on cash value growth
   - Provides tax-free access to cash value
   - Allows for distributions not considered income when calculating Social Security tax

Read more about using life insurance as an asset class in one of our earlier articles.

Most retirees look to squeeze every penny from retirement assets, especially when choosing the payout option from an annuity or pension plan. The lifetime option, which guarantees a consistent stream of income for the lifetime of the annuitant offers the largest benefit but leaves nothing for a spouse or partner. Pension maximization uses a life insurance policy to provide for the surviving spouse.

Business strategies

Every CFO is tasked with using capital wisely and reducing financial risk. When anticipating future liabilities for retirement benefits or deferred compensation, a permanent life insurance policy can be very attractive option for a business. Rather than using company capital for distributions, a life insurance policy that accumulates cash value can be a secure source to provide the promised benefits without impacting company cash reserves and other assets. In fact, just as in the examples cited above, policy values can be accessed, tax-free, for any purpose; using distributions to ease a tight cash flow situation or avoid high interest rates when financing equipment. There will be an interest charge for the borrowed funds, but the net interest rate is often considerably less. IUL is the favored product for COLI (company owned life insurance) and contributes to the revival of this market.

Life insurance is widely used in Buy-Sell agreements, typically funded with a life insurance policy. Companies with closely held ownership, insure the lives of each owner, so that when the owner dies or decides to retire and receive cash for the value of the business, the cash needed is available without requiring a forced sale, a search for a new partner, or impacting cash flow.

Firms looking to raise capital may overlook the role life insurance can play. First, when borrowed via a policy loan, cash value can be a tax-free source

of capital. Secondly, cash value can be withdrawn rather than borrowed however, it will be a taxable event and will permanently reduce the death benefit. Third, when it is important to maintain the death benefit level, the policy value often serves as collateral to secure capital from a financial institution.

There are many business uses for permanent life insurance, for more details about the role of life insurance in business check out 5 Ways to Use Life Insurance to Achieve Business Goals.

How permanent life insurance stacks up to other financial products

Financial products come in many forms, each developed to fulfill specific objectives. Life insurance makes an equal if not greater contribution to a portfolio of assets, in part because the guarantees and the living benefit features of permanent life insurance. The unique features of life insurance, the tax-deferred growth, the tax-free death benefit, and the tax-free access to cash value, increases the flexibility of other assets in the portfolio. For example, policy cash value can be used to supplement income when equity prices are low, affording the option to postpone the sale of equities until values stabilize.

	IUL	Whole Life Insurance	Certificates of Deposit	Equities	Savings Accounts	Retirement Accounts (IRA, 401(k), etc.)
Guaranteed Future Cash Value	✗	✓	✓	✗	✗	✗
Potential for Non-guaranteed Cash Value Growth	✓	✓	✗	✓	✓	✓
Guaranteed Death Benefit	limited	✓	✓	✗	✗	✗
Tax-deferred Growth	✓	✓	✗	✗	✗	✓
Tax-free Funding of Long-Term Care Costs	✓	✓	✗	✗	✗	✗
Tax-free Death Benefit	✓	✓	✗	✗	✗	✗
Disability Protection	✓	✓	✗	✗	✗	✗
Market Volatility	✓	✗	✗	✓	✗	✓

For more about life insurance contributes to a complete financial portfolio, read Using Life Insurance as an Asset Class.

Whole Life or Indexed Universal Life

Both whole life and indexed universal life will deliver the value of tax-deferred accumulation, tax-free distributions. Both products offer varying levels of guarantees. Participating whole life insurance policies pay dividends in addition to cash value accumulation. Policyowners may choose from one of five dividend options, one of which can be used to offset premium payments. Another option provides additional paid-up insurance benefits.

The opportunity of higher interest crediting rates and guaranteed minimums add an attractive component to IUL. Strategies calling for planned withdrawals may be better served by IUL products. As with any financial portfolio it is always wise to diversify products and investment strategies. IUL is not a panacea but it can provide unique options and tax benefits when planned distributions and reasonable market fluctuations are accurately illustrated. Use the chart below to compare the features of both products.

	Whole Life	Indexed Universal Life
Tax-free death benefit	✔	✔
Tax-deferred growth	✔	✔
Variable earnings based on equity markets	✖	✔
Guaranteed death benefit	✔	For limited time
Flexible payments	✖	✔
Potential for non-guaranteed cash value	✔ From dividents	✔ From upside equity markets
Tax-free funding of long-term care costs	✔	✔

In the end, you can rely on us to guide you through the choosing the best product and carrier for your situation and objectives. We are life, disability, and long-term care experts here to help you achieve your financial objectives. **Call us today at 845-495-5000!**

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