Answers to the top IUL questions

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Over the last two years, we have been privileged to assist dozens of clients with setting up part of their income in retirement to be tax-free. For some, we use Roths. For many, we use a combination of Roths and **indexed universal life (IUL)**.

We like IULs a lot, but the first thing we tell clients is that they are complicated. In fact, they are so complicated, that we won't let a client pull the trigger on them unless we have discussed them at three different meetings.

Most of our clients don't know anything about the concept of tax-free income in retirement through life insurance products. So, we take our time explaining all the pros/cons, expenses, IRR, what can go right and what can go wrong, in addition to the fun part — estimates on how much money they might have in retirement that they don't have to report to Uncle Sam.

Here are the top questions I get about this product:

1. What if the insurance company fails or goes bankrupt?

- *My answer:* That's a good question. I looked at all the insurance companies that went under in the last few years, while the economy has been so bad, and discovered only one small life insurance company out of Kentucky went bankrupt. It was so small, I had never heard of it.

- Typically, when insurance companies get into financial trouble, another insurance company will buy them out and pick up all the contracts. Remember, your policy is a contract, so the new insurance company is legally bound to honor the terms of the new contract.

- If your company is not purchased by another, almost every state has a guaranty fund that handles life insurance company bankruptcies. This works like the FDIC, which insures against bank failures. The guaranty funds will pay your claims, particularly for your cash value, up to a certain limit if your insurer goes under. In most states, the maximum aggregate benefit for all claims is $300,000 for **life insurance policies**.

- Also, the financial reserve requirement for life insurance companies is much higher than banks. That is why so many banks failed in the Great Depression and, by contrast, so few insurance companies met the same fate.

- Finally, this is the reason we want to make sure we only deal with insurance companies that are financially strong.

2. Can I choose how to invest my money?

- Actually, the insurance company makes that decision. Here is how they do it: Let's say your premium is $1,000 per month. The insurance company takes $950 of that premium and buys an investment that guarantees they will get back $1,000 at the end of the year. That is how they can guarantee that your cash value won't lose money in a down year. They use the other $50 to buy options — specifically, calls — the right to purchase a particular investment if its price falls within a specific range. In good years, the $50 will provide some extra income — that is how they can get extra rates of returns on the product. In bad years, the options expire as money runs out and there is no extra return for the policy owner.

3. What happens if I can't make a payment, lose my job, or face some catastrophe?

- That is one of the great things about this product — the**premiums** are flexible. First, there are a band of premiums, set between a minimum and a maximum premium. Obviously the more money you invest, the better it will do over time. So, one thing you could do is go to the minimum payment, and then, as your life improves, you can go back to a higher payment, or even dump in a load of cash if you get a bonus or sell your business.

- Let's say you have a year where you can't make any payments at all. Depending on how long you have been in the product and how the market has done, that might be OK. We will run some illustrations for you and let you know where you stand.

- At this point, we might run “bad case” scenarios for our clients. Note, we never call them “worst case” scenarios. Depending on the client, we might show premiums paid for 10 years and then taking a four-year break and resuming premiums, or just paying for 10 years and then stopping.

- *Note to advisors:* We usually have sample illustrations along these lines in case clients ask about it. We just pull the illustration out of our tool kit. To save time, we just ran standard illustrations showing these scenarios on a 25-, 35- and 45-year-old male and one for females.

- *Another note to advisors:* If your favorite carrier will allow, we also use their online illustration tool with certain clients and have them tell us their “what ifs” so they can see what the consequences would be.

- Finally, back to the client — We explain that within limits, we can reduce the **death benefit**, which means more of their premiums will go to savings and less will go into the cost of insurance.

4. What if Congress changes the tax benefits?

- At this point, I explain that these insurance products used to have even better **tax advantages**. In those days, the wealthy would put in millions of dollars so they could have tax-free savings account. The IRS got onto this tax strategy and passed a law that limits how much can go into these policies. However, all the lucky people who had been socking money away managed to have their policies grandfathered in and keep their tax benefits.

- Nothing is certain, of course, but I have never even heard of any potential regulations that would impact these, and the only conclusion I can come to is most of Congress must have permanent life insurance.

5. Why aren’t more people doing this? Why haven’t I heard about this?

- First, I explain that it takes an affluent client — the younger and the healthier, the better. They need to be good savers and willing to commit to a **long-term saving** strategy.

- The only clients I have had who declined this product had no disposable income — they were living fist to mouth and couldn’t save anything. This is the wrong product for clients who don’t have an emergency fund or a steady stream of disposable income.

- Now, I rarely tell clients the next part: When I first got involved with financial planning (deep sigh) back in the 80s, the industry was focused on a comprehensive approach that included investing as well as insurance. With the big push to an AUM model over the last 25 years, many advisors either ignored insurance or never took the time to learn it. As a result, many of the advisors who would have been up to speed with these techniques 30 years ago don’t recommend these solutions because they don’t understand them.

- Another factoid I don’t explain to clients because I don’t want to bash other companies: Finally, some of the top insurance carriers are still using the same type of products that they used 30 and 40 years ago. They have not caught up with the new trends. The new products are not designed for death benefit as much as they are designed for retirement income. As a

are not designed for death benefit as much as they are designed for retirement income. As a result, their captive agents don't have access to these tools.

If you get questions about this product, please pass them on to me, and I will answer them in future articles.

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