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What You Should Know About 702 Retirement Accounts

If an insurance agent tries to sell you a whole life policy as a retirement saving vehicle, here's the inside scoop.

Mark Henricks | Mar 8, 2017

Can a kind of life insurance policy peddled as a 702 retirement account be a key part of your long-term financial plan? Depending on who you talk to and your current situation, the answer could be affirmative or negative.

702 retirement accounts are named after the section of the tax code that regulates life insurance. And, in fact, a 702 retirement plan -- it also may be called a 7702 or 702(j) plan -- is a life insurance policy.

702 accounts are a type of insurance called whole life. Unlike a term life policy that runs for a specific period such as 10 or 20 years, whole life provides a death benefit for the insured's full lifespan. The entire premium for a term life policy pays for the death benefit. It is generally the least expensive life insurance for a given benefit.

Only part of a whole life policy premium pays for insurance. The rest accumulates to build up cash value. A 702-type plan is tailored to maximize cash buildup rather than insurance benefit.

Premiums for whole life are higher than for a term life policy with a similar-sized death benefit. However, if a term life policy expires or lapses before the insured dies, there is no financial benefit to the insured.

A whole life policy's cash value lets the insured get some benefit from the premiums while still alive. The insurance company invests the cash value. And, like tax-advantaged accounts like IRAs and 401ks, growth is free of federal income taxes.

Commissions and fees consume part of whole life premiums, especially at first, so there may be little cash value for several years. But after cash value becomes

significant a policyholder can borrow from the insurance company using the cash value as collateral. Loans can be used for any purpose, including to fund retirement.

And, unlike when a retiree withdraws an IRA or 401(k) or other tax-deferred retirement account, loan proceeds from cash-value life insurance are free of taxes. A retiree can borrow up to the full cash value of the policy. When the retiree dies, the loan is repaid by the death benefit.

Some advisors like 702 plans for their combination of tax benefits and freedom from tight regulations governing loans and withdrawals from 401ks and similar retirement plans. "I am a big fan of it," says Thomas J. O'Connell, president of [International Financial Advisory Group](#) in Parsippany, N.J. "I don't have a 401(k) anymore. I put all my available cash into cash-value life insurance policies."

Cash-value life insurance, O'Connell explains, creates a pool of capital a policyholder can borrow against to buy a car, acquire business equipment or purchase a second home as well as fund retirement. Meanwhile, the policy's cash continues to be invested and to increase. And unlike a 401(k) plan invested in the market, the cash value of a life insurance policy is protected against market declines, O'Connell adds.

Also unlike tax-deferred retirement plans, there are no caps to the after-tax amount that can be invested in a 702 plan, says Alan Dole, a wealth manager at [Equity Concepts](#) in Henrico, Va. And the death benefit that will eventually be paid to the estate is also free of income tax, Dole adds. "There are a lot of positive aspects," he says.

A retiree might borrow against cash value without intending to pay it back while alive. After calculating a safe withdrawal rate unlikely to tap out the cash value during his or her lifetime, the retiree would anticipate that the death benefit would cover the loan.

702 plans are not for every saver or every advisor. Dole says younger consumers with student loans and mortgages, especially if they aren't taking full advantage of employer matches in a company-sponsored retirement plan or lack emergency savings, are likely better off addressing those needs before purchasing cash-value life insurance.

O'Connell says a 30-something might do well to look at a cash-value policy, however. That's in part because they are funded with after-tax dollars and he anticipates tax rates to rise.

For any saver, a 702 plan is a long-term vehicle, not for short-term savings. Not all savers will be a position where it makes sense to use cash-value life insurance as their only saving vehicle. If an advisor or broker suggests putting all your resources

into a 702 plan, Dole suggests looking for an advisor with a more diversified approach.

However, for some savers in some cases, a 702 account can be part of retirement planning. "We're not talking about your grandma and grandpa's life insurance," O'Connell says. "We're talking about specifically structured cash value life insurance policies trying to maximize cash benefits and tax value and not necessarily death benefits."