You Only Need Life Insurance While You're Working

Myths are an interesting mix of a little fact and a lot of fiction — they're often a way to validate long-held beliefs, regardless of their accuracy. At the Ethical Edge, an Insurance Fiduciary℠, we work with clients to optimize their insurance assets in the same way they manage their other important assets. As individuals approach retirement, they often ask, "Should I keep my life insurance or cash it in?" One of the **myths** surrounding life insurance is that you only need it while you're working.

Things to consider

The question of keeping — or getting rid of — life insurance at retirement depends on the individual's circumstances. We like to ask our clients to consider:

- **Whether or not it's likely they'll leave an estate large enough to be taxed?**
- **If they have a closely held business for which liquidity will be needed at the time of ownership succession?**
- **If they have charitable bequests?**
- **If they have ongoing family obligations, such as providing financial continuity for family members with special needs?**
- **If their retirement resources are vulnerable to volatility, taxes, inflation, or considerations of liquidity?**

Something else to consider

Then there's asset allocation — diversifying assets within a given risk tolerance — which takes on greater importance in retirement, including whether or not to retain an existing life insurance policy.

But let's look at why it might *make sense to hold onto that life insurance* — particularly if it's a whole life policy.

The markets' effect on retirement plan distributions

For retirement, most people save (i.e., "accumulate" money) toward a specific annual retirement income goal. But the challenge can be how to properly distribute or "decumulate" the retirement savings properly — so that it lasts a lifetime.

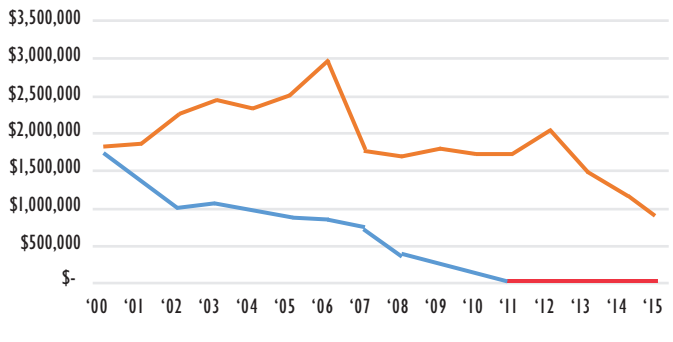
Let's consider an individual who has $2 million in retirement savings — all invested in the S&P 500® Index between 2000 and 2015.

- **Scenario 1:** The blue and red lines in Chart 1 below show annual distributions of $150,000, but this individual **runs out of money** just after 11 annual distributions.
- **Scenario 2:** The orange line in Chart 1 shows what would have happened if those distributions had occurred "in reverse," and the results are quite different. **There would be nearly $1 million in retirement savings** by 2015.

There's a huge discrepancy between these two scenarios — due to what we call "the dilemma of sequence of returns." But this example clearly illustrates the effect that the stock market can have on retirement savings accounts when withdrawals are being taken. This is, in fact, one of the most important issues in retirement planning.

Chart 1

Decumulating from $2,000,000 with $150,000 Yearly Withdrawals



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The problem is that there's little that retirement savers can do about it unless they have a *resource that's uncorrelated to the equity markets* — such as a whole life policy — from which to take retirement income withdrawals when markets are in a decline.

How a whole life policy can help preserve retirement assets

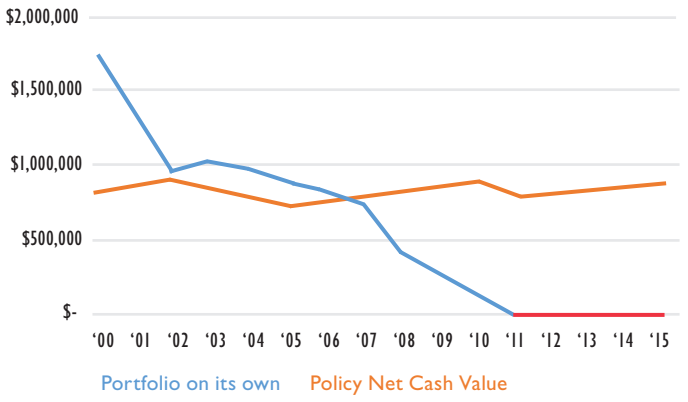
In Chart 2, you can see the results of selectively taking policy loans[1] from a whole life insurance policy — *instead of* taking withdrawals from retirement savings during those years that equities are declining in value, as measured by the returns of the S&P 500 Index. This is compared to *not* tapping the cash value.

- **Scenario 1:** The blue and red lines show how the retirement plan's account value is depleted in 2011, after making $150,000 annual withdrawals, due to the downturn in the markets.
- **Scenario 2:** The orange line shows the individual taking out $150,000 from retirement savings, *except* following a negative market return, when he borrows $120,000[2] from his policy's cash value instead.

It's clear to see that the cash value of an existing life insurance policy can be just what is needed to balance out the asset allocation of a successful plan of retirement savings distribution.

Chart 2

Using Uncorrelated Resources for Retirement Income



The result?

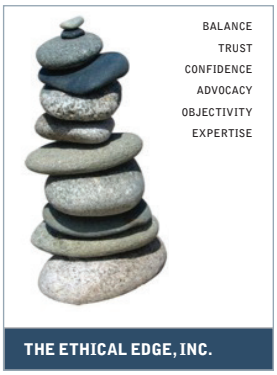
When the policy is tapped following years of negative equity market returns, at the end of the 15-year period, there is **more than $750,000 remaining** in the retirement account.

To learn how your life insurance policy can help to protect your retirement assets, talk to a financial representative from a highly rated carrier.

This article was written by Richard M. Weber, MBA, CLU®, AEP (Distinguished), of The Ethical Edge, Inc., a California-based, fee-only insurance fiduciary. Mr. Weber, 2012-2013 President of the 14,000-member Society of Financial Service Professionals, has more than 50 years of experience in sales, training, product design, senior management and compliance. His firm provides training and consulting services that help empower life insurance agents, financial planners, advisors and their clients to explore and view life insurance in the broader context of financial planning.

[1] Policy benefits are reduced by any outstanding loan or loan interest and/or withdrawals. Dividends, if any, are affected by policy loans and loan interest. Withdrawals above the cost basis may result in taxable ordinary income. If the policy lapses, or is surrendered, any loans considered gain in the policy may be subject to ordinary income taxes. If the policy is a Modified Endowment Contract (MEC), loans are treated like withdrawals, but as gain first, subject to ordinary income taxes. If the policy owner is under age 59½, any taxable withdrawal is also subject to a 10% tax penalty.

[2] Assuming there would have been an effective tax rate of 20% on the $150,000 distributions from his retirement account (that he didn't take), the client only needed to withdraw $120,000 from his policy to have the same net income.



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