



Sound Financial Bites 086 - Basics of Life Insurance Part 6 Episode Transcription

“It has to be a policy that one day will endow and second, it needs to be a policy whose death benefit is guaranteed.”

Paul Adams: If we have death benefit of whole life insurance, and that is equal to the amount of assets that we have in our capital at work at our old age, we have the opportunity to actually consume the assets while the life insurance continues to grow, because, remember, it grows unimpinged.

Welcome to Sound Financial Bites, where we help you with bite-sized pieces of financial and life knowledge to help you design and build a good life. The knowledge that has been shared from stages at conferences, pages of national business magazines, and clients living across America, our host, Paul Adams, now brings directly to you.

Paul: Seriously, Paul? Six episodes so far on life insurance? What are you doing to us? We're loyal listeners. How can you hurt us the way you're hurting us right now? Our ears are bleeding hearing about life insurance. Once again, here's why. It is one of the few multi-million-dollar decisions everybody makes, people don't take enough time to really understand the amount or type, and then if they do understand the amount or type, or they bought life insurance, many people listening to this may have just bought life insurance from somebody who is selling life insurance, not doing planning, in which case, you can learn things here, they're going to help you to better apply the vehicle. With me today, in studio, is Cory Shepherd. This is where we would do the applause track if we had one. Cory Shepherd.

Cory Shepherd: I don't have the soundboard set up yet.

Paul: We don't know how to do it. So, Cory is President of Sound Financial Group. He does a great job of keeping me on track and pointing me in the right direction, making sure we're creating great content for the audience like this video for all of you, and author of Cape Not Required.

Cory: Which you can see just off of Paul's elbow there on the screen behind you.

Paul: It's a great book, great book. I'm Paul Adams, CEO, founder of Sound Financial Group. We're super-happy to have you. Okay, so today, we're going to talk about how you can use the death benefit of your life insurance while you're still alive - that's right. Without dying, how can you use the death benefit of your life insurance?

Now, first off, what this requires, to have the conversation we're about to have, is we begin to look at our finances very differently than we've been taught. For instance, financial institutions would really appreciate it if you just thought about your 401(k) as it relates to what your 401(k) is going to have as an outcome.

They'd like you to think of a 529 plan as just what the 529 plan is going to do, the Roth IRA for what it's going to do, and in fact, if you look at many financial plans, it shows the growth of each individual asset, and they're really not coordinating the growth of those assets. In many of those financial planning programs, you need to just Google and find a few yourself. It's future value on all of the individual accounts, and they only start to integrate them upon distribution, which is great, but we want to start integrating those while you're still growing the money, and one way that we do that is thinking ahead for how the death benefit of our life insurance could actually be



Sound Financial Bites 086 - Basics of Life Insurance Part 6 Episode Transcription

used while we're alive.

Now, the conversation, here's the disclaimer. The disclaimer is what we're talking about from here forward only applies to what kind of life insurance, Cory?

Cory: Whole life insurance for me, mutually-owned life insurance company.

Paul: Yeah, so we're going to talk about how to use the death benefit, etcetera. But, what's critical is that it has to be a policy that, one day, will endow, and second, it needs to be a policy whose death benefit is guaranteed. You'll notice that insurance companies are really like the only people out there that can legitimately legally use, in sanctioned, saying the word "guaranteed".

If we're going to be using our money differently in our old age, it has to have a secure backstop. So, that's why only whole life insurance, only that issued by a mutual life insurance company: variable life, variable universal life, guaranteed universal life, all of those things might be able to be used in some fashion similar to what we're talking about now. You need to consult an expert before you would do any kind of spend-down against those assets because they may not be as guaranteed as the whole life insurance, which we're going to discuss today.

"If we're going to be using our money differently in our old age it has to have a secure backstop."

Let's pivot. Let's talk about what it's like to retire with or without whole life insurance. So, where we're going to start is the idea of just building up \$3 million of assets. Now, if you watched our other videos, if you've been listening to the podcast, what you're going to notice is that if you have \$3 million of capital at work and we take a sustainable distribution rate, which is 4% per year, then we've increased our likelihood, significantly, to have that money last.

We can't take out 10% per year and expect the money to last because the money goes up and down over time when we invest. If up years and down years, if we take out too much in our down years, it's a little bit like we're eating our seed corn before we replant the field. So, we need to only take 4%. So, \$3 million equals \$120,000 a year of income.

For the sake of this example, we're going to say that it's taxable, and you can see it ends up as a smaller net amount than we have by taking the \$120,000 a year. So, \$3 million, we take \$120,000 a year, our \$3 million stays intact, and we ultimately leave \$3 million to somebody. This is the typical way people retire, it's the typical capital at work model, and what people don't think about is people might say, "Well, I want more income; I'll just spend the \$3 million." So, what's the problem that we just start drawing down the \$3 million in the typical retirement scenario? People have no life insurance. They just have the \$3 million, Cory.

Cory: The only people that I've seen actually say what you just said, Paul, are people who are not actually in retirement in that moment, or maybe there was one or two who are actually in retirement, but in about 30 seconds after explaining what was going to happen if they did that, they're like, "Oh, no, no, I don't want to," because it's drawing down your total asset base, so next year, you're back to your normal percentage withdrawal, your income is smaller because it's a smaller capital amount, and anybody who's uncertain about how long they have left to live in retirement is not going to want to watch their assets start dwindling. They get in a race that they don't want to win.



Sound Financial Bites 086 - Basics of Life Insurance Part 6

Episode Transcription

Paul: That's right, yes. Think about, from an income perspective, every year, if the \$3 million is your cookie jar, and your \$120,000 a year is the cookie you pull out every year, well inflation is acting on both the cookie jar and the cookies, meaning every single year, the cookie jar gets a little bit smaller, but also, the cookies look a little bit smaller.

Even if somebody said, "Well, I'm going to go ahead and keep the money in for 15 years, and then I'm going to spend down the \$3 million," the problem is we don't know when our last day on Earth is going to be, and as a result, if we spent down the money, and this is why people of means tend not to spend down their money despite all of the somewhat cocky things you hear even from radio hosts that say, "Well, I'm just going to let the check for the mortician bounce," I will promise you there is no level of luxury you can live in your old age, even if it lasts for 20 years, that would make up for six months of abject poverty at the end. No way. And people realize that.

Who I'm talking to right now, what I want to communicate this to is everybody who's younger. As Cory said, we never really hear this from anybody who's age 65 or older saying, "I want to spend it all and not leave anything behind." It just doesn't happen. Younger people say that before the grip of their mortality's got them and before the meaning of future generations has really hit them dead center.

Cory: That's a future me problem.

Paul: I love future Cory problems. In fact, most of the things that I do are future Cory problems. Us recording this video is a future Cory problem. He has to make sure it gets edited, uploaded, all that good stuff. I guess, the other teams, it's future Lea problems.

Let's talk about what can happen differently. I want you to imagine this. Imagine you're out in the garage, and your spouse is inside the house, and you're out in the garage, and you walk in, and you've got a brilliant idea. You've got a little bit of dirt on your hands, you just finished washing your hands, you're drying them off with a towel, and you look at your spouse and you say, "I've got an idea. I have done some math." I think you're going to love this. "I'm 65 right now, we're about to retire, taking \$120,000 a year."

After tax, obviously, that gets cut down to a lot less, "I think we can spend a lot more money in our old age. I think we really could. I think it's going to be great. I think what we'll do is just spend down all the money, all \$3 million based upon my life expectancy. We'll just run out by the time I'm dead." So, you walk in, tell your spouse that, and say, "Don't worry. I'll be dead by age 85 and the money will be gone." What's your spouse likely to say to you? In your case, Cory, if you said that?

Cory: Throw the mug.

Paul: These beautiful mugs, they would get thrown across the room. You might be sleeping on the couch. You're certainly not going to be able to make any financial decisions in your household anymore if that was your idea. Very simple, it's an awful idea, and your spouse will tell you it's an awful idea for one of three reasons, "A, hey genius, you might outlive your age 85 because people are living longer than ever, B, I'm going to outlive your age 85, you *fill in the blank here*. So, I'm not going to let you spend down the money. And third, maybe most importantly, I'm not okay



Sound Financial Bites 086 - Basics of Life Insurance Part 6

Episode Transcription

with zero legacy. It doesn't mean that we've got to leave people rich, but I want to leave some kind of legacy," for one of those three reasons you'll be sleeping on the couch that night.

But now, let's go back and replay the story for just a moment. I want you to also imagine that while you were in the garage, you were cleaning some things up, and you found your old whole life insurance policy, and you look at that life insurance policy, and it's got about a million and a half of cash value in it. It also has \$3 million of death benefit, and you found that and you tucked it away in a Rubbermaid container, put it up on a shelf. You walked back into your spouse and you say, "I have an idea."

This is scenario 2, this is person B, "I have an idea. Here's what I want to do. I'm 65. Now, I'd like us to take more income at retirement. We can effectively take twice as much after tax income every year in our old age because we're going to spend it down, we're going to access the principle of our money. If that's an after-tax account, that could be all tax-free. I'd like to spend that down, we're going to spend far more money out of our same \$3 million, and we're going to do it based upon my age 85, but it's okay. I'm going to be dead by then. Oh, by the way, so silly, I forgot to mention, the whole life policy we got many many years ago from those advisors we worked with?" and your spouse goes --

Cory: Who? What?

Paul: Yeah, "What does that have to do with anything?" and look at you a little funny, maybe like you're looking at this video right now, they look at you a little funny, "I put that in the big orange Rubbermaid container on the top shelf of the garage. So, before you give me your thinking on us spending down all our money based upon my mortality, my lifespan, I wanted you to know there's guaranteed death benefit in the garage that'd be there for you when I die, guaranteed." Now, what does your spouse say, Cory?

Cory: Well, incidentally, it's a reminder of one of the things that we talked to clients about over and over again, which is spouses must meet together with their advisors. Had you both, in our example, met together with that advisor, it wouldn't be so much of a, "Hey, what now? What advisor, what insurance?" and this is why for years down the road. So, the spouse may not quite be all over it at first. They might need a little more math and, "Look, hey, lay it out for me," but they're not throwing cups across the table. They're like, "Okay, maybe this sounds good."

Paul: You're saying there's a backup plan.

Cory: I'm saying there's a chance.

Paul: A backup plan, not a chance. But, there is. There's a backup plan. There is money on the table that is going to jump into existence on your financial life when you die, guaranteed. That changes the game, and here's how it changes it. Now, we have the ability to spend down the \$3 million. Now, you get a chance to take twice as much income, a little more than twice as much income off of the same \$3 million of investments.

Now, here's the thing that causes a ton of confusion. Both of these people with \$3 million, for the sake of our example, have the exact same investments, exact same portfolio. They're both taking



Sound Financial Bites 086 - Basics of Life Insurance Part 6

Episode Transcription

off, we're assuming, just a 4% rate of return in old age to make it easy and parallel for the sake of 4% distribution. But, if rates of return were higher, then both people, A and B, would have more money.

Here's the thing I want you to easily consider. We have more money because we had access to the \$3 million of principle because of the guaranteed financial backstop of whole life insurance on the balance sheet. That guaranteed backstop gave us the ability to spend other money on our balance sheet any way that we wanted to, and in this case, you can see we spend more money out of \$3 million in the second scenario than we spent. Even if you gave us \$6 million in the first scenario, we wouldn't spend as much money as we did with \$3 million in the second scenario.

Here's what we have to consider. If we have the permission - think of the life insurance as a permission slip from our future selves - we now have the permission to spend our money in a very different way in our old age. Because we have the ability to spend our money very differently in our old age, we can spend twice as much money off of the same amount of capital.

Consider, is it going to be easier to fight and scratch, work our tails off, save like crazy, maybe have to wake up in the middle of the night and take some Maalox because we're worried about the market as we get closer to old age just so we can try to build a total of \$6 million of assets, or are we better off building up \$3 million of assets, and then buying the \$3 million permission slip that's also building in the background in our old age?

Our clients universally answer, "If it works for them. We need to have good enough health, because if we don't have good enough health, then the returns may not work right." So, that all has to be tested, and that's the most important thing. You don't want to do any of these strategies with an advisor unless they're testing them one next to the other. If you just put all the money in this kind of thing versus if you did life insurance, it needs to be compared.

The amazing thing is that this life insurance policy just produced a far better overall rate of return to your financial life because of its existence even though it may have only returned a 4% return on its cash, the effective outcome may be much closer to a double-digit before tax rate of return on your balance sheet. Why? Because, we integrated it.

Now, often, Cory, this is where people say, "What's the catch?" Like, if this does so well, if you're telling me that this life insurance might behave like a 12% before tax rate of return when we coordinate other assets, then there's got to be a catch. Why isn't everybody doing this? How do you usually answer that question?

Cory: Number 1, you have to be able to qualify. So, you have to be healthy enough and young enough when you start it for the numbers to all work out.

Paul: So, number 1, everybody can't is the first answer. That's a great way to look at it, like why doesn't everybody do this? Because, everybody can't do it. Check one.

Cory: I think two will be that -- well, another reason why lots of people can't is it just takes some discipline and strategy. If someone's only saving the minimum into their 401(k) to meet their employer match, and no other money is being saved on their balance sheet, then it doesn't work



Sound Financial Bites 086 - Basics of Life Insurance Part 6

Episode Transcription

that well, because you've got to be able to split it up and save into two different pots.

Paul: Exactly right, and that's the other thing I always think about is that there's no orchestration. Too often, people are looking at each individual tool: here's how the 401(k) does, here's what the Roth does, here's how da-da-da, and they're not saying -- given the landscape of everything you've got, that would be like moving a piece on the chessboard only thinking about the single piece versus the entire chessboard. We've got a bunch of pieces already in play. How are we best going to utilize them?

So, most people can't, and of the people who might have the ability, if you're not doing the orchestration, for instance, having only a whole life policy, if that's all you got in your old age, it's probably only worth its cash. But, if we have a whole life policy, which we can match to other assets, it might open up the opportunity, give a bunch of money away to charity, which has huge tax advantages during our lifetime without disinheriting our children.

Cory: That's a huge one. I have run into some clients recently where they don't even have any children, but maybe they have other people in the family, and they want to pass on some money, but then, they need healthcare, and they're not actually taking the steps, right now, to provide themselves all of their own comfort in their old age because it becomes this conflict of, "Every dollar I spend on myself is one less dollar I leave behind."

Paul: Yeah, odds are legacy will matter to you. I mean, when we looked at people and what happens when they age, legacy just matters to an overwhelming majority of them, and even though most of them might have thought, in their 40's, they wouldn't care...

Cory: They do, yeah. I think the last one is that people don't understand the strategy. There's so much information out there that they get paralyzed. Funny thing is most folks don't actually understand their 401(k). We're auto-enrolled, and it's just going in. So, we're already doing lots of things inside a strategy because we don't understand, and that's just where we help folks take the time to pull back and see what is going on here in all these different areas, not just the magicians saying, "Let's look at my hand right here. Let's look at this one thing, let's see how it all fits together."

Paul: If we build it all together, and now we have a strategy both during accumulation of how we might utilize the life insurance, but now, also in our old age, the most effective way to distribute from other assets in accordance with the life insurance, we can actually have the life insurance work more effectively for us, but we have to have all of it, we have to have both, and that's something we see often is, so often, people are getting, say, all of their insurance advice from somebody who all they do is insurance, or they're getting their insurance advice from somebody that all they do is portfolio management.

Necessarily, those two different groups are giving different answers, but it's almost always based upon their opinion. They're not journeying a client through the math, making them learn it for themselves, which is what I encourage all of you to do. If you're currently working with an advisor, if you're not a fit for us, or you haven't applied to become a client of ours and gone through our assessment process, that's okay, you don't need to.



Sound Financial Bites 086 - Basics of Life Insurance Part 6

Episode Transcription

What you can do is go out to your advisor and say, "Help me understand how this math works," and then you can begin to get a little more rigorous. If you've got an advisor that doesn't understand how to use the death benefit of life insurance? No big deal. Point him to this video, say, "I'd like you to watch this before our next meeting because I want to talk to you about it," and if your advisor is not willing to invest the time to go look at some material that you found on your own, that may be a good reason to start looking for an advisor, or if they only offer opinions based upon it, but they're not willing to show you the math, then that could be a reason that you may want to explore other options.

The big story here: if we have death benefit of whole life insurance and that is equal to the amount of assets that we have in our capital at work in our old age, we have the opportunity to actually consume the assets while the life insurance continues to grow, because remember, it grows unimpinged.

It's not impinged by taxes, it's not impinged by market volatility. Whole life insurance is an asset that's guaranteed to go up and not go down, and because of all those things, it becomes this incredible financial backstop that's growing in the background like a snowball rolling downhill unimpeded to put money on your balance sheet on a guaranteed basis at your old age after you've spend some other money, giving you the greatest access and control of your capital. So, that is how we effectively spend our death benefit of our life insurance while we're still alive is it actually changes the way we can use other assets.

Anyway, guys, I hope this has been useful for you. We're going to do a part 7 of this video where we're going to talk about and review everything we've talked about so far so you'll have one short video you can go back to and figure out which one of the videos you may want to review later.

I hope this has been helpful to you, we hope it's helped you design and build a good life, and if we can ever be of help or support to you, don't hesitate to reach out. We'll take you through our philosophy conversation, and we'll make sure that you understand if you're a fit for us and we're a fit to you to go through our design process and help you design the good life that you want to build for you and your family.

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Sound Financial Bites 086 - Basics of Life Insurance Part 6 *Episode Transcription*

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