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TEMPEWICK WEALTH MANAGEMENT

FIVE STAR WEALTH MANAGER
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About our firm:
Tempewick Wealth Management is a wealth and insurance firm with professionals specializing in estate and investment planning, business succession and wealth transfer.

Planning for Retirement With Cash Value Life Insurance

The prospect of a financially secure retirement is a key goal of most successful people. Unfortunately, relatively few options exist to accumulate sufficient retirement funds in a tax-efficient way. Traditional retirement accounts (such as 401(k)s or IRAs), which offer the benefits of tax-deductible (or pre-tax) contributions and tax-deferred growth, also have annual contribution maximums. These limits may restrict affluent individuals from fully achieving their financial objectives.

How Can Life Insurance Help?

Cash value life insurance can be a valuable means of saving additional funds for retirement. Premiums paid into permanent life insurance contracts can generate a cash value which grows tax-deferred. At retirement, tax-favored loans and withdrawals can be used to access the cash value, creating a stream of cash flow to supplement other retirement income. Moreover, life insurance policies feature a death benefit that will be received income tax free by heirs.

Forms of Cash Value Life Insurance

- Whole Life Insurance
- Current Assumption Universal Life Insurance
- Equity-Indexed Universal Life
- Variable Universal Life

Some of these policies involve market risk, including the loss of principal. A properly licensed and qualified insurance professional can help determine the appropriate form of insurance to fit specific needs.

How Cash Value Grows

Cash value life insurance has a level premium that is larger than necessary in the early years of the policy to offset the increased costs of insuring the individual in the later years. This excess premium is invested and kept in an account known as the cash value account. In the event that you surrender the policy before death, this excess premium and its earnings are returned to you.

Whole life policies offer "guaranteed" cash value accounts that increase based on a formula determined by the insurance company. (Guarantees are subject to the claims-paying ability of the insurer.) Universal life policies offer cash value accounts that track current interest rates. Variable life policies allow their owners to invest in accounts that operate like mutual funds, meaning that their cash value accounts can be invested in bond, stock, and other funds, known as subaccounts. The cash value will grow or decline based on the performance of the underlying subaccounts.

Other Things You Should Know

- A significant advantage of cash value life insurance over most traditional retirement accounts is that loans and withdrawals from insurance policies are optional and may be taken at any time. By contrast, certain accounts (such as IRAs) require minimum distributions after age 70½ and subject distributions to early withdrawal penalties if taken prior to age 59½.
- Depending on the policy performance, the cash value available for loans and withdrawals may be worth more or less than the original premiums contributed.
- An insurance policy may lose some of its tax advantages if it becomes classified as a Modified Endowment Contract (MEC). When a distribution of cash value is made from an MEC, taxation may

occur. If the loan or withdrawal is taken prior to age 59½, a federal tax penalty of 10% may also apply.

- Surrender charges usually apply to cash value life insurance policies in the early policy years.
- Withdrawals and loans must be properly structured, as they will reduce the policy death benefit and may cause the policy to lapse. If a life insurance policy lapses with an outstanding loan, adverse income tax consequences may occur.
- In most cases, premiums are not tax-deductible.

Loan Term

Most premium financing programs available today offer a loan term between 1 and 10 years. Often, the borrower will be allowed to re-qualify for the loan at the end of the term and establish a new loan with new terms.

Interest Rate & Payment Options

Premium finance programs often use a benchmark rate plus a "loan spread". Usually, the benchmark rate used is either Prime (the lending rate commonly used by U.S. Bank) or LIBOR (the London Interbank Offered rate), an internationally accepted lending rate published daily by Thomson Reuters on behalf of the British Bankers' Association. The loan spread varies from lender to lender, but typically falls between 1.5% and 4.0%. Interest rates that are tied to a benchmark rate are usually variable, and are a reset on at least an annual basis. Some loan programs offer a fixed rate for the life of the loan, and may use a different method for determining the interest rate. Interest may be allowed to accrue and become due at the end of the loan term. More commonly, loan interest is paid at the end of each year of the loan.

Prepayment Penalties

Some programs will charge the borrower a penalty fee if the loan is repaid prior to the end of the term.

Collateral Requirements

The primary collateral for the loan is almost always the cash surrender value of the policy. Additional collateral is required and must be in a form acceptable to the lender. This can include cash or cash equivalents such as a letter or credit, certificate of deposit, or securities. In some instances, a less liquid form of collateral, such as real estate, may be acceptable.

Considerations

- ❖ Should the value of collateralized assets decrease, the lender may require additional collateral from the borrower.
- ❖ The lender has the right to call the loan at the end of the term.
- ❖ If the interest rate index used for the loan benchmark rises, the total interest charge on the loan will also rise. The life insurance could be subject to forfeit if the borrower is unable to keep up with the interest payments on the loan.
- ❖ Downgrades in the credit rating of the carrier may result in the lender terminating the premium finance arrangement at renewal and/or call the collateral for the loan.
- ❖ The illustrated performance of a life insurance policy is based on a series of assumptions. Should actual conditions be less favorable for the policy, the growth of cash value within the policy may suffer. As a result, the lender might require additional collateral to be posted.

Exit Strategy

When entering into a premium finance agreement, it is wise to have a definitive plan on when and how the loan will be repaid. If the intent is to use cash value or death benefit from the policy to repay all or a portion of the loan at a future date, the policy should be carefully monitored to ensure that it is performing as expected. A contingency strategy should also be developed which may involve the possible planned liquidation of other assets to repay the loan.