Episode #170: How to Compare IUL to Alternatives Using a Wealth Report

Video Transcription

Hello, and welcome to another episode of "Money Script Monday." My name is Adam Reyna, and I'd like to thank you for attending. Our topic for today is indexed universal life. And what we're going to do is actually compare indexed universal life, or what we'll call IUL, versus some various alternatives, and we're going to do that using a wealth report, which is a report you may have seen, or you may be thinking about looking at with your insurance agent or financial advisor.

Before we get into some of the benefits of indexed universal life, or we talk about the way it works or we use any sort of comparisons, let's first talk about some of the reasons you'd like to use indexed universal life, whether you're in your accumulation phase, whether you're a pre-retiree, or maybe even already retired, it could still have a good fit for you. One of the main benefits of indexed universal life is that it's a very conservative wealth accumulation vehicle. And when I say conservative, what we're looking to do is actually take some risk off the table. Especially if you're almost to retirement or even in retirement, you're a lot more subject to some of these risks and they could have a pretty big impact on your portfolio and even the quality of your life. The risks that we'll talk about today, you can see here are taxes, stock market volatility, longevity, and inflation.

Tax risk is what we would say the fluctuating tax rates, right? Nobody knows, nobody has a magic ball. We can't predict what taxes are going to be next year, three, four years out, five years out. And especially with things like a pandemic or an election that really adds a lot of tax volatility, and everybody's tax situation is a little bit different. we always want to make sure that you work with a tax professional along with your financial advisor or insurance agent to make sure you're customizing a plan that really works for you. the question is, do you want to pay taxes on the seed or the harvest? What that means is would you rather pay taxes today, knowing exactly what those taxes are going to be and be completely tax-free moving forward, which is indexed universal life. That's what we do with IUL. Or would you rather defer some taxes and then somewhat roll the dice because when you go to take money out of a tax-deferred account, you're subject to whatever the tax rate is at that time. again, work with your agent or your advisor on what's the best fit for you there.

Number two, we're going to talk about stock market volatility. I think everybody knows stock market volatility is when you have the opportunity to lose money due to a negative return in a stock market portfolio, a mutual fund, a brokerage account.

But stock market volatility could also work the other way as well, of course; you can have upward volatility. the question is, if your portfolio were to take a 10% or 15% hit, is that going affect the quality of your life? Are you going to have to live off less? Are you going to have to earn more in the future? what we're doing with indexed universal life is actually taking away all stock market risk, where you would actually not see your account value go down in a negative market because we have what's called a 0% floor. again, we got rid of some tax rate risk and stock market volatility, and then we need to talk about longevity.

Longevity is the fact that people are living longer and longer these days. we work on retirement cases. We really need to plan for sometimes 25, 35, maybe even 40 years. with all the advances in technology in the medical field, people are living longer and longer, so we have to create a plan that lasts longer and longer. In longevity, we actually sometimes call the risk multiplier. the longer you live, the more subject you are to tax rate changes, they can go up, they can go down. Same with stock market volatility. The longer you live, it's not a question of if, it's how many times will the stock market fluctuate during your retirement years.

Then finally, we talk about inflation. inflation is probably about the most steady risk we see on this board because it averages about 3% per year. And basically, if you don't have an increasing income or inflation-adjusted income or earmarked income for later on in life, the purchasing power of your dollar is going to decrease every year.   that's the risk there. We've got the four risks. again, indexed universal life has the ability to adjust and address all of these risks. now that we know what indexed universal life does and why we're even considering it, let's look at some alternatives. I'll step over here so you can see our alternatives here. we have indexed universal life, we have a taxable account, which would be like a checking, savings, money market account, something that you're getting taxed on every year. You have your tax-deferred account, which you're simply just going to defer taxes like we mentioned earlier. And then eventually, when you go to take distributions, you'll pay the taxes at that time. that's like your 401(k)s, IRAs. And then your tax-exempt account would be like a Roth account or maybe a municipal bond portfolio.

For example, purposes here, we're just going to use kind of an apples-to-apples comparison of a tax-exempt account versus the IUL. our sample report here that we're looking at is actually a 50-year-old male. just kind of an average age there, a 50-year-old male. He's going to pay $30,000 a year for 10 years. a total budget of 300K. And then we're going to show distributions at his retirement age of 65 years old for $40,500. And we assumed a tax rate of 28%. what we're doing in this report is we're comparing all of these the exact same. they all have the same age. They all have the same 6.5% rate of return. They all have the same $300,000 worth of premium. And then we start the income distribution at 65 on all of these 4 accounts as well.

What this chart here is going to show us is the values and distributions at age 85, we've taken $40,500 a year for 20 years, if you did that using the indexed universal life policy, your total income at that time, your living benefit, your tax-free distribution to yourself to cover retirement taxes is over $850,000, then if you were to actually pass away at that time, your beneficiary would still receive $485,000. the total benefit there is, again, your living benefits as income plus the death benefit to your beneficiary, which equals $1.3 million. And then we can look at taxes and fees. the fees in the IUL are a little bit different than these other accounts, but the cumulative fees from the time he started this account at age 50 to age 85 are $120,000.

Like we mentioned earlier, the IUL takes away all tax risks. we have no taxes moving forward. our cumulative is $120,000 fees plus taxes is $120,000. And then if you look at the age you run out of money, the IUL would keep going as long as you're alive, subject to some returns, but a very conservative model that would never run out of money. what we're looking at is great benefits for you and your beneficiary, and we're looking at pretty low fees. And your taxable account has $472,000 of income by age 85, not quite less than half, but we're getting pretty close to half. You see $667,000 from your tax-deferred and $667,000 from your tax-exempt.

And if you notice, the death benefit to your beneficiary is zero. The reason being is when you pass away with any of those three accounts, whatever's leftover is considered the death benefit. you as the retiree got to use that money while you're alive, but there's nothing left for your beneficiary. you got less income during retirement, and then there's nothing left over for your beneficiary. the total benefit of $1.3 million to the IUL versus your taxable tax-deferred or tax-exempt account is a pretty big spread. something you really want to consider. And then we'll do the same thing, but on the fees and taxes. with your taxable tax-deferred and tax-exempt account, all of them are taxed a little bit differently, but they all get charged fees essentially the same way.

In this case, we assumed a 1.5% expense percentage. that means you're paying 1.5% of whatever amount of money is within your account. in the beginning, it's very low, but, of course, as that account grows, you're going to pay more of an expense, 1.5% every year. the fees on your tax-deferred account if you noticed are the largest. The reason being is you're not paying taxes and you're not tax-free, so it's a much bigger account balance, which looks great on paper, right, but the IRS basically has a permanent lean on that money. when you take distributions, you have to pay taxes, or if you pass away and anything's leftover, your beneficiary has a pretty big tax bill as well.

If you look at the total fees on all those accounts, the IUL at 120K fees plus taxes, the taxable account at $187,000, your tax-deferred at $433,000, and then your tax-exempt at $122,000, believe it or not, the IUL is the lowest there. And again, we never run out of money in the IUL, whereas the other 3 accounts run out late 70s and early 80s. again, this is something that you really want to work with your insurance agent or financial advisor on because we can customize a wealth report for you. We can find a premium that's comfortable for you. And ultimately, we want to address some of these risks and then make sure you don't run out of money and you're doing it in a cost-effective way.

For any questions, of course, reach out to your insurance agent or financial advisor. Again, my name is Adam Reyna, and I thank you for attending.