

Episode #309 – How to Get GUARANTEED Income From an IUL

Hi, welcome to another episode of Money Script Monday. My name is Brian Manderscheid. Today I want to teach you how to get guaranteed income from an Indexed Universal Life policy. Now an Indexed Universal Life policy can potentially be a great solution to provide not only a supplemental tax-free retirement income stream but also life insurance coverage for you and your family. However, there are some potential issues with the life insurance policy, specifically IUL, that may potentially cause a policy to lapse if it's not properly structured, and not properly managed over time.

So today what I want to do is talk about first participating loans, how they work, some pros and cons, and second, get into two different case studies of how to use index universal life to provide guaranteed lifetime income. All right let's first talk about participating loans. Now, the reason they're called participating loans is the money that you borrow from the insurance company continues to participate in indexed returns. While this may look great on an illustration with, let's say a level illustrated rate and a level borrowing cost, the reality is there are benefits and there are cons of these types of loans.

First, let's talk about the pros. There's the ability for you to have potential positive arbitrage between the borrowing rate from the insurance company and the index returns on cash value. For example, let's say you had a 5% loan cost, contractually guaranteed from the insurance company, and let's say on average you earn 6% in the underlying indexed returns. That would mean a 1% positive arbitrage between the borrowing rates from the insurance company and the index returns on cash value.

Second, we have the ability for uninterrupted compounded interest. Now in a traditional vehicle, let's say a savings account or investment

account, if you need income, you would take a withdrawal, which would reduce your principal balance and reduce the ability for that account balance to continue to grow. With a participating loan, you're not withdrawing money from your policy, you're instead borrowing from the insurance company with your life insurance, cash value, and death benefit as collateral.

Lastly, the loan itself is unstructured, meaning there's no loan qualification, there's no pre-loan payment terms. You could pay the loan off at your own pace, or even not pay it off at all and have the death benefit ultimately, pay off any outstanding loan balance upon your passing.

Next, let's talk about some of the negatives. While the example I talked about before with a 6% illustrated rate, a 5% loan cost of 1% arbitrage may potentially happen over the long run, the reality is there will be years where the policy earns a 0% return and you're still being charged the 5% loan. You're actually not earning a positive arbitrage. You're actually having a true 5% loan cost in that scenario.

Second is the potential for the policy to be overleveraged, over loaned, or lapsed, and this problem isn't inclusive of just indexed universal life. This can happen with many different types of permanent life insurance policies. The downsides if you were to over loan your policy, and your policy lapses, are that not only would you have no more ability to access the policy for income, you no longer have death benefit for your family, and you also have a phantom income tax bill from the IRS and have to pay potentially a pretty hefty tax bill, which would be a pretty bad scenario.

Lastly, is ongoing management. The IUL policy when used this way is not a set and forget it. Instead, there are potential moves you'd have to make such as allocation changes, death benefit changes, rejections, and taking out an appropriate amount of loans to prevent the policy from lapsing. Now there are some over-loan protection riders available on most policies that may prevent a lapse, but still, these are definitely some things

to keep in mind. So that's a little bit about participating loans, let's get into the case studies of how to create guaranteed income from your IUL.

Now, the first scenario is a client who uses a feature with one specific insurance company called a lifetime income benefit rider. Very few insurance companies have a feature like this, and this particular client, he's 42 years old and in excellent health. He doesn't have a pension from his job like a lot of people, and he realizes Social Security is 25 years away, and it may not exist, at least in the capacity that exists today with the Social Security Trust Fund expected to go under or go negative in 2033, at which point Social Security may be forced to lower payments for retirees. So, while he has his retirement plan through work that he's actively contributing to, he does have \$2000 a month of discretionary cash flow that can be meant for long-term planning.

This client decides to fund an index universal life insurance policy with this lifetime income benefit rider feature. A couple of notes on it is the rider comes onto the policy at no cost. However, if he decides to use the rider, there is a monthly deduction that would occur which would reduce the future death benefit values if the rider were used. Now for this particular example, we illustrated him turning on the lifetime income benefit rider, the LIBR, at age 67, again to provide this contractually guaranteed, and also tax-free, retirement income.

Now to go over some of the results, let's first look at the cash value at age 66, the year prior to retirement. Based on the guaranteed scenario, which is a contractual guarantee of 2% and the maximum mortality charges, the insurance company can charge the guaranteed cash value at age 66 is just over \$600,000. Keep in mind he's funded \$2,000 a month for 25 years, which is a total of \$600,000. So worst case scenario, he can walk away with just about 100% of what he put in and would have had life insurance coverage along the way and also the access and liquidity of capital. You also have to think and keep in mind if this type of scenario was actually occurring, all of his other investments would probably not be doing

very well if the stock market again was flat or negative for that extended period of time, and the insurance company had to charge those max mortality costs.

Under a 3% scenario, which is the current fixed rate, the projected cash value is about \$777,000. Using a 6% assumed illustrated rate, again non-guaranteed could be higher or lower, the projected cash value is just short of 1.2 million. Now, the very next year, the client decides to enact the lifetime income benefit rider to supplement Social Security, supplement what he has from his employer-sponsored plan, and his 401K.

Again, looking at the worst-case scenario, the guaranteed paycheck he gets from the insurance company is \$42,000 a year for the rest of his life without any taxes due to the IRS. If you think about it, that's a pretty strong income even in the worst case. At that 3% scenario, again, 3% is the current fixed rate and the current mortality cost, the guaranteed income at that point would be about \$55,000, which was much better than the worst-case scenario. At that 6% assumed scenario, it could be higher or lower, non-guaranteed, the projected, income is almost \$84,000 on a tax-free basis. He turns on the rider, and gets that paycheck annually, semi-annually, quarterly, or monthly for the rest of his life.

Now, one of the potential downsides of this rider is there is a rider cost when you turn it on. So, the death benefit in the later years of life, by taking the income, the loan cost, and the rider fee should be depleted pretty significantly over time. Essentially the trade-off is a guaranteed paycheck for the rest of his life versus having less death benefit for his beneficiaries.

Moving on, let's look at the second case study. This one's a little bit different. This particular client didn't go with or didn't choose a company that had this sort of lifetime income benefit rider, but still wanted not only guaranteed lifetime income but also a death benefit for her family. Now for this scenario, she's a 47-year-old female in good health or great health, and

her father just recently passed away unexpectedly. Now her father did have the foresight in planning and had a \$500,000 life insurance death benefit for his only daughter. Now she did have some immediate expenses, some renovation costs, some debt repayments, some debt consolidation, and wanted to have some money for liquidity. But she wanted to use \$250,000, or half of the life insurance proceeds, to not only provide income for her in retirement when she needs it but also to provide a legacy for her kids, similarly to what her father did for her.

For this case, we actually put the \$250,000 into a premium deposit account, which is currently being credited a 5.25% interest rate and that premium deposit account pays life insurance premiums for a 10-year time frame. Think of a premium deposit account as a savings account within the insurance company. Again, the ability for her to make a one-time payment and have that pay the life insurance premiums for a 10-year time frame. Now what the plan is with this particular policy is when she gets to retirement age at age 67, is to take a withdrawal of her cost basis or what she put into the policy of \$250,000 and purchase an annuity with an outside insurance company. Based on today's rates, which again may be different in the next 20 years, the annuity would provide about \$1,600 a month for the rest of her life, a part of that would be taxable and part of it would be tax-free, something called an exclusion ratio.

To go over some of the numbers with this particular scenario is the cash value at her age 66, again the year prior to her retiring, at the worst-case scenario, which is the 2% contractual guarantee plus the max mortality cost was about \$280,000. She put in \$250,000, there was some interest earned over the 10-year funding, and she could walk away with more than she put in. In a worst-case scenario, she would have also had life insurance, death benefits for her kids, and access to liquidity and capital if needed.

Using the 6% illustrated rate, again non-guaranteed could be higher or lower. The projected cash value at 66 is just short of \$700,000, which again is quite a bit more than she put in. Now in this case, again, there's no

lifetime income benefit Rider, but instead, she would take a withdrawal of cash value and purchase an annuity with whomever is a top-rated carrier and payer at the time, providing roughly \$1,600 a month at least based on today's rates. Now looking at the death benefit at her age of 85, again, part of this was not only income for her, but also legacy and death benefit for her kids or even grandkids at that point, at the worst case scenario, which again is a 2% contractual guarantee, max mortality costs, the death benefit is about \$34,000.

Well, that doesn't sound like a lot. That is at least a burial policy, so to speak and again, the worst-case scenario, plus you also got her \$250 back out, which was used to purchase the annuity. Under the 6% assumption, again, current mortality costs could be higher or lower than six but based on this projection, the death benefit at age 85 is over 1.5 million income tax-free to her kids. So again, not only did she withdraw her basis, the \$250, and purchase the annuity to get lifetime income for herself, but she also had access to capital along the way, life insurance, death benefits for her beneficiaries, plus, at age 85, roughly life expectancy, a million and a half dollars of a tax-free death benefit for the next generation or even the next generations.

After going through not only what participating loans are, the pros and cons, and these two case studies, I hope you can see that indexed universal life when properly structured for the right person, can actually provide a significant amount of guaranteed tax-free income or guaranteed income through these two strategies, while also providing valuable life insurance to death benefit for your family. If you have any questions about the material presented today, please contact the advisor who sent you this video to get started. Thank you very much, we'll see you next time.