TENON FINANCIAL
RETIREMENT PLANNING & INVESTMENT MANAGEMENT

Retirement Planning Insights

September 2023

Tenon Financial Happenings

- Conference season

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Tenon Financial Happenings

Pumpkin spice and an industry conference

And just like that, so ends another summer.

As a kid, I used to not like the end of summer because it meant school was starting again. It's not that I disliked school, per se. But how many kids do you know would rather go to school instead of have more summer???

Now, as an adult, I'm quite okay with the end of summer. It means cutting the grass is soon ending (I generally enjoy cutting grass but get a bit tired of it by mid-August), sweater weather and pumpkin spice everything! (Yes, I'm obviously a pumpkin spice person 😊)

Also, the end of summer means conference season is firing up; there are TONS of financial planning industry conferences in the fall.

In October, I'll be one of the presenters at the Rock Retirement Club's annual in-person member meet-up in Fort Worth, Texas. This will be my third time presenting there; it's always a good time!

In September, Michelle and I will be attending the XY Planning Network's annual conference, which will be in Atlanta.

XY Planning Network is a network of well over 1,000 fee-only financial advisors/planners. It's a great group where everyone shares the common goal of advancing the financial planning profession, specifically without the focus on selling products.

Additionally, I'll be one of the presenters at that conference, too. I'll be educating folks on how to charge flat annual fees for a combined financial planning AND investment management offering.

XYPN LIVE
I'M A SPEAKER!
Charging Flat Fees for Planning AND Investment Management
Andy Panko, CFP®, RICP®, EA
ATLANTA, GA → SEPTEMBER 19-21, 2023

For as forward-thinking as most members of XY Planning Network are, many are still hung up on the inertia of thinking advisory fees for investment management need to be a percentage of assets. This is categorically false, as I shall show.

Hopefully Michelle doesn't heckle me TOO much during the presentation!

Enjoy your Septembers (and the pumpkin spice…)

-Andy

Retirement Planning Happenings

How to use Indexed Universal Life ("IUL") insurance as a source of cash flow in retirement

This article is part two of a three-part series about Indexed Universal Life ("IUL") insurance policies.

Last month's newsletter had the first part; an explanation of the basics of IULs. Next month's newsletter will have the third part; the truth behind common IUL sales pitches. This month's newsletter is about how to use IULs as a potential source of cash flow in retirement.

As summarized in last month's newsletter, sales of IULs have been increasingly focused on pitching them as a tax-free retirement "income" tool. I put the word "income" in quotes because it's a misnomer to call it income. It's technically loan proceeds, which is "cash flow," not income. But I digress.

When insurance salespeople pitch IULs as a retirement income tool, they often refer to it as a Life Insurance Retirement Plan, or LIRP. LIRP isn't a formal name of any particular product. It's more so just a general term that refers to using an IUL primarily as a source of loans during retirement.

As discussed in last month's newsletter, this series on IULs isn't to try to say IULs are good or bad, or that you should or shouldn't consider them. Instead, it's simply a way to try to inform and educate you all about them, as IULs are - in my opinion - heavily oversold and often misrepresented.

Anyway, let's now move on to how you can potentially use a cash value life insurance policy such as an IUL as a LIRP by borrowing money against it during retirement:

The gist and goal of a LIRP is to have a permanent life insurance policy's cash value build up as much as possible over time so it can eventually be borrowed against in retirement (hence the name Life Insurance Retirement Plan).

Assuming the policy stays in force all the while, the loans do not have to be repaid while the policy's insured is alive. Instead, when the insured eventually dies, the outstanding loans will then be paid off by the insurance company keeping some of the policy's death benefit. The remaining amount of death benefit will be paid out to the policy's beneficiary(ies).

For example, if the policy's stated death benefit is $500,000 and there are $400,000 of loans outstanding when the insured dies, the beneficiary(ies) will receive $100,000 (not $500,000) of payout upon the insured's death.

It's important to know that the intention of using a permanent life insurance policy as a source of retirement cash flow is predicated on the assumption that loans - not outright distributions or surrenders - are taken against the cash value.

Like any form of debt, loans against a life insurance policy are not considered taxable income (because they're not actually income in the eyes of the IRS; they're just borrowings). It's this concept that belies claims that IULs used as LIRPs can create "tax-free retirement income."

However, if actual distributions are ever taken out of the policy's cash value, there may then be tax on at least some of that distribution. Specifically, if a policyholder distributes more than the total amount of premiums paid into the policy, the amount of distribution above and beyond the cumulative premium payments is taxed as ordinary income in the year of the distribution.

For example, assume you paid $5k into an IUL every year for 10 years, for total premium payments of $50k. 10 years after that, your policy's cash value is $110k. If you were to take out that $110k, you would have to pay ordinary income tax on $60k of it ($50k would be treated as a tax-free return of your initial contributions into the policy, and $60k would be treated as fully-taxable interest).

One of the benefits of borrowing against cash value life insurance is that the money borrowed isn't actually taken out of the cash value and therefore the full amount of cash value will continue to earn interest.

For example, assume your policy's cash value is $100k and you take a $40k loan against it. You will still have the full $100k earning interest crediting (as opposed to only having $60k earning interest...$100k original cash value minus $40k loan). Separately, you'll have to pay interest to the insurance company on the $40k loan. And if you choose to not pay additional money into the policy to cover the cost of the loan interest, the loan interest will be deducted from the policy's cash value. But nonetheless, the amount of loan doesn't directly reduce the amount of cash value that stays in the policy and continues to earn interest crediting.

This leads to an important consideration when taking loans against cash value life insurance; the interest paid on the loan could potentially be higher than the interest credited to the cash value.

For example, assume the $40k loan mentioned above is charged 5% annual interest by the insurance company. The total interest expense for a year would be $40k * 5% = $2k. Even though the full $100k of cash value is still able to earn interest, it's possible the interest credited for a year could be less than the amount of interest expense on the loan.

In a worst case scenario, the interested credited could be zero yet, in this example, there would still be $2k of loan interest that needs to be paid. If you choose to use your policy's cash value to pay the interest instead of separately paying the interest with additional funds, your cash value will decrease by $2k. Furthermore, there will still be the policy's cost of insurance and other fees that need to be paid and will come out of the cash value, further reducing it.

With this in mind, it's important to remember that IULs can potentially lose money, even though the interest credited to the cash value will never be less than zero.

There is much more devil in the details of properly structuring a LIRP, such as ensuring it has an "overloan protection" rider to help prevent the policy from having too much loan against it, catastrophically collapsing and potentially leaving the policyholder with a large taxable event from being forced to surrender the policy.

Additionally, many IULs used as LIRPs will have some sort of long-term care and/or chronic illness rider(s) added to them. Also, it's imperative to know that LIRPs are intended to be a lifetime commitment as it takes years - often decades - for the potential value of them to fully manifest.

While the above summary provides only a high-level introduction of LIRPs, it should hopefully at least provide a base level of knowledge from which you can further learn and understand the intricacies and complexities of using IULs as a retirement cash flow tool

That’s it for this second of three parts about IULs. In next month’s newsletter, I’ll shed light on the truths behind many common IUL sales pitches.

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