Retirement Traps

Sales Primer

The value of cash value in retirement

As your clients save for retirement, offer them ways to help avoid retirement traps. These traps, such as taxes, penalties and market risks, may impact their retirement income in ways they never expected. Cash value life insurance may help.

Advantages of using life insurance to supplement retirement income

No other financial vehicle can offer all the benefits that life insurance can provide:

- Income tax-free death benefit
- Ready access to cash value
- Tax-deferred growth
- No distribution requirements or penalties
- No contribution limits
- No effect on Social Security unless policy is surrendered

Consider permanent life insurance

Life insurance has no contribution limits or income eligibility limits.

Qualified plans, such as 401(k) plans and IRAs, are a good place to start saving for retirement. However, these types of plans alone will likely not be sufficient for your clients to reach their retirement objectives. Additionally, many retirement savings tools enjoy tax-deferred growth, but may pose limitations on the amount that can be saved or, if income is too high, limit the use of them.

Policy owners are generally not restricted on the amount they can allocate towards a life insurance policy, allowing the potential to build even more cash value.[1]

Life insurance has no penalties on withdrawals.

If your client experiences a financial emergency or plans on an early retirement, they will discover that accessing account values from qualified accounts like a 401(k) can create adverse tax penalties, particularly before age 59½.

Part of a retirement savings strategy should keep some assets available that won't incur these penalties. Money from a policy's cash value can be taken at any age without tax penalty, although contract surrender charges may apply in the early years of the policy.[2]

Life insurance can help reduce the impact of a bear market during retirement.

As clients save for retirement, they know they're going to have to ride out a few down markets. But once they retire, those same market declines could possibly jeopardize the amount of money they have to live on.

Life insurance is generally not affected by short-term volatility and may help your clients get through changing economic conditions. Additionally, it can help reduce the impact of a down market during retirement by providing an alternate source of funds in a year when the market has a decline.

Life insurance can help in the event of a serious illness.

Life insurance with an accelerated death benefit rider can help ease the financial strain of a serious medical condition by providing an advance on the policy's death benefit while the policy owner is still living.

Life insurance may guarantee lifetime income.

In addition to loans and withdrawals, life insurance with a lifetime income rider guarantees the policy owner income for life – that's money they cannot outlive. There is no charge for this rider until it's activated.

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Life insurance can help increase your client's legacy.

Tax-deferred retirement plans such as traditional IRAs and 401(k)s have what is called a Required Minimum Distribution (RMD), money that is required to be withdrawn whether it's needed or not. If the RMD isn't taken, there may be an excess accumulation penalty of 50% on the amount not distributed. In addition, qualified plan balances may be subject to double taxation – both income and transfer taxes upon death, which often reach 30% or more.

If you have clients who don't need their RMD withdrawals, they can use them to purchase a life insurance policy. Properly designed and funded, this will provide an income tax-free benefit to their loved ones.

Using the fact finder

The Retirement Traps Fact Finder will help identify the types of savings vehicles your client is using and provide a framework for some of the challenges they may face in retirement. The fact finder outlines the three general types of savings vehicles:

Tax-Exempt or Tax-Free

Withdrawals from tax-exempt or tax-free sources don't incur income taxes. Examples include:

- Municipal Bonds
- Roth IRAs
- Permanent Life Insurance[2]

Tax-Deferred

Tax-deferred accounts shelter investments from taxes as long as they remain in the account. Examples include:

- 401(k) Plans
- 403(b)Plans
- Traditional IRAs
- Pensions
- Annuities

Taxable

For taxable accounts, investors must pay taxes on their investment income in the year it was received. Examples include:

- CDs
- Money Market Accounts
- Bank Accounts
- Mutual Funds
- Stock Dividends
- Corporate & Treasury Bonds
- Real Estate

Life insurance and retirement savings

In addition to providing a valuable death benefit, a life insurance policy may provide funds during retirement. The cash value in a permanent life insurance policy accumulates on a tax-deferred basis. At retirement, your client can get money they need by taking a loan from their policy's cash value. They won't have to pay taxes on the loan amount unless the policy lapses. This potentially reduces the amount of taxes they'll need to pay in retirement.[2]

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1 Contributions in excess of certain guidelines will disqualify the policy as life insurance for federal income tax purposes or may classify the policy as a modified endowment contract, thereby eliminating certain tax benefits.

2 Tax law permits a policy owner to withdraw life insurance policy cash values up to the policy owner's basis or investment in the contract without income tax consequences. Withdrawals and loans will reduce the available death benefit. Withdrawals beyond basis may be taxable income. Excess and unpaid loans will reduce policy value and may cause the policy to lapse. If a policy lapses, unpaid loans are treated as distributions for tax purposes. For more information about the tax results of life insurance, consult your attorney or tax advisor.

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