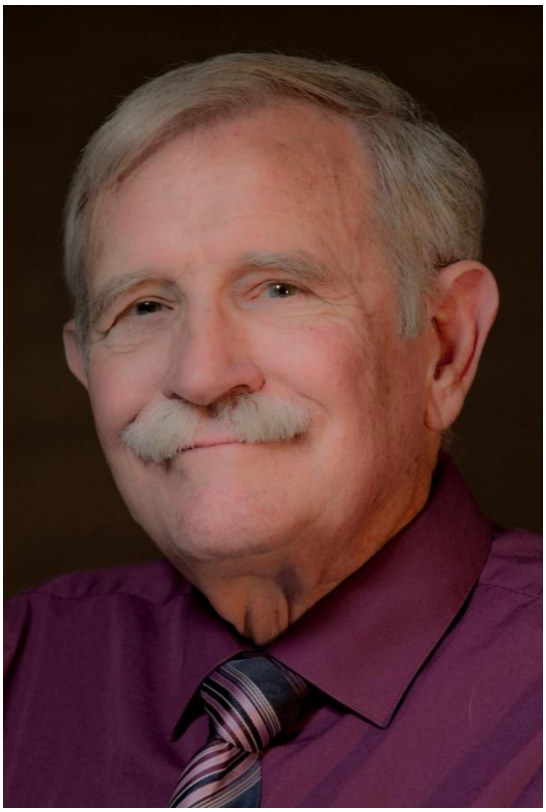

Life Insurance and Retirement –

The Unvarnished Truth

By

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The decisions you make ‘today’ determine ‘tomorrow’s’ choices.

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Chapter 1
The Insurance Authors' Dilemma

Having spent over 45 years in the life insurance business, I had become frustrated with the books that I had been reading that promote permanent life insurance in a manner that I considered exaggerated or flawed. I shared my frustration with several people who responded by challenging me to write a response that says what should have been said by these other authors.

Upon accepting the challenge, I asked a group of my friends to give me their thoughts on life insurance. What follows is the not so surprising e-mail from one of the women in this group. "I probably won't be of much help to you, but this is how I feel about insurance: I have no life insurance and don't want any. I have selected my 'hole-in-the-ground' and paid for it. I don't understand term or whole life, and at this point, I don't want to learn. When I was young I might have been interested in hearing about it, but I couldn't have paid for it."

Then she said, "Regarding insurance, I think you're damned if you do and damned if you don't. I hate it - or at least, the idea. I also think most insurance salespersons will say whatever it takes to sell a policy." I can say that the above quotes are not at all unusual. Add to that there are many who call themselves experts, who say that life insurance is a terrible investment, that you will do better simply by putting the premiums into the bank.

Because of these widely held views, in my opinion, in their attempts to overcome people's hesitancy to purchase anything from life insurance companies, the authors of these books, to one degree or another, have erred. Add to this the fact that insurance company illustrations have become more cautious, while the books' illustrations remain based on out-dated information. These relatively popular books have good points. Nevertheless, each has fallen short. In some cases this may have been intentional. I prefer to believe that what was written (or not written) was usually the result of naiveté or lack of knowledge.

My problem with most of these books is that while the motivation has been to get people to buy sufficient amounts of life insurance, which is reasonable, the authors have either made exaggerations, or they have used the wrong type of policy for their purposes. However, the previous quotes might give us an idea of what drives these authors. It isn't that they are trying to deceive the readers. They are struggling with human nature.

I have come to realize that, as a general economic principle, one could describe people as either net producers or net consumers. At different times in our lives we may be one or the other. At birth we are consumers, and that is usually reinforced during most of our formative years.

Toward the end of our lives we again become (or we have hoped to become) consumers. In between as responsible people we need to be net producers. For most of us this is difficult, because we became accustomed to being provided for. Because of this, saving for future needs or wants has been of low priority.

Our government has responded to the truth of this by establishing programs to counter our innate self-centered approach to financial decisions. Because we have a tendency to consume all that we produce, (and with the advent of credit cards, more than we have produced) we have been forced to set aside part of what we earn for our families in the event of death or disability, and for ourselves if we should make it to the age of retirement. For most of us, this is Social Security.

Social Security is not enough, so our representatives created tax incentives to encourage us to save part of our productivity by means of Individual Retirement Accounts and 401(k)s. On top of these, the United States Department of Labor has determined, that when one retires, if he or she is married and has a pension, this pension is to be reduced to allow for the spouse to still receive a portion of what was created before retirement, after the death of the retiree. (From this point on I will use the masculine gender as inclusive of the feminine. It is too tedious to continually say ‘he and she’ or vice versa.)

I believe it is our nature to consume, rather than to conserve what we produce. This is who we are. This is the number one issue insurance agents have to compete with. The insurance industry’s task is to find a way, a story, that will convince each of us to deny our basic nature, and move us to discipline ourselves to do that which is best for ourselves, our families, and ultimately for the common good.

When someone says of himself, “My death is more costly than the purchase of a hole in the ground,” he is acknowledging that he is a producer. The job of the insurance agent is to help that person to determine just how much his worth as a producer is, and inspire him to assure those who depend on him that they will never have to be without his productivity. It is one thing to get a person to see his worth. It is quite another to get him to do something about protecting that worth. This, I believe, is why these authors are prone to over-sell their insurance products.

The fact that you have acquired this report suggests that you may have decided to do something about your financial future. It may be that you have read *Tax-Free Retirement* by

Patrick Kelly, or Douglas Andrew's *Missed Fortune* and *The Last Chance Millionaire*, or Pamela Yellen's *Bank on Yourself*. I encourage your reading of these books. I have read them, and I have found their basic concepts are sound. I am grateful for their contributions in helping the general public understand principles that have been widely shared within the community of professional life insurance agents.

Whatever it is that has gotten you this far, my goal is to get to the facts without the hype, so you, in dealing with an insurance agent, can feel confident in what you decide to do. I will attempt to explain what each idea is in easy to understand terms. I will include warnings where necessary. I will create comparative illustrations in order to give you an idea of how these products work.

I will include instructions for how to determine how much insurance your family will need. I will describe various retirement alternatives besides life insurance that may be suitable. When helpful, I will provide internet resources that you can use to determine what you need to do. What I will not do is fill this book with a lot of anecdotes designed to browbeat you into buying life insurance. I believe that you are reading this book because you have already decided to be a conscientious net producer, who sees the value of protecting that productivity.

Chapter 2
Safety in Numbers

When I was seven, my grandmother told me that I must save for a rainy day. Of course, I had no idea what she was talking about, but now I understand. We must spend less than we earn in order to be ready for whatever comes. However, we don't know when it is going to rain. Therefore, whether we like it or not, we buy storm insurance.

All insurance is based on a simple fact. We are unable to completely prevent all forms of risk. We can try, but accidents still happen. We still get sick. Homes may burn to the ground. People are sued for real and imagined offenses. At times nature reminds us how weak we really are when it hits us with winds, floods, earthquakes, sickness and death.

The good news is that we have had enough collective experience with all these events, that we can estimate how often these calamities will hit within any representative group. Any one of us could be devastated by the cost of one of these interruptions in our lives. However, if we pool these risks among a large group of people, we can remove the sting by each of us paying a little bit of the cost.

There are two ways that we can do this. We can form a cooperative, a group that is assessed for the expenses of these events as they happen. Fraternal insurance companies and old mutual insurance companies have worked that way. Or we can form entities that accumulate funds in advance of the crisis. There is a distinct advantage in doing things this latter way.

What if, in the first case, there was too great a need for the members to suffer the assessment? The cooperative would have to borrow money to cover the cost of the claim. Then there would have to be assessments to pay back the loan with interest. Thus, paying for the event after the fact is more expensive than having the money already available.

On the other hand, if funds are collected before they are needed, these funds can be put to work, generating income that can be accumulated along with that which had already been received. This is more cost-effective, and the way most insurance works.

All insurance companies I am familiar with work on the latter principle. When this process of advanced pooling of risk is understood, it becomes a lot more appreciated. For

example, my home owners insurance at the time this chapter was being written was $700 for the year. Now it's possible that I might be able to get it for less elsewhere, but consider what it does. If I were to have a house fire, it might cost me $200,000 to restore it. Plus, I would need rent money for lodging till my home has been rebuilt. Suppose it takes six months to get back into my home, and rent is $1,600 per month. Just between these two costs I would be out almost $210,000. At $700 per year, it would take me 300 years to save up the money to cover just that one loss.

Another way to look at it, at $700 each, it would take the help of 299 other people to pay for my loss. The reason my premium is so little is that there are these hundreds of people that also are contributing premiums so that each one of us can be at peace when thinking about what could happen. Individually, we aren't preoccupied with where the company puts our money, or the rate of return (earnings) on it. The only things we are concerned about are whether the premiums are fair, and that the company will come through when there is a claim.

Many of us, if we could, would go without insurance. But mortgage companies won't lend to us if we refuse to carry homeowners' insurance. And the state will take away our driving privilege if we don't carry auto insurance. But neither of these requires that we carry life insurance. The decision to buy life insurance is a personal choice, which usually does not come from some third party mandate.

Because we are reluctant to let go of our money for something that we cannot consume or play with, life insurance generally is sold by tying it to something else that the potential buyer is interested in. From a company's perspective, and certainly that of the other insureds, there is a strong incentive to come up with a successful story, for it takes hundreds and thousands of insureds to make the protection, the sharing of risk, work.

Usually, that something is a plan that gives the insured access to money for future delivery. This could be more retirement income, a plan that lowers taxes, or money that can be borrowed 'tax-free.' These are suitable couplings of incentives with responsibilities. However, in focusing on the rewards, there is too little attention paid to the variables that can impact the end results.

These variables include demographics, investment risks, taxes, timing, internal costs and government regulations. It is with these issues in mind that I will discuss the different types of life insurance and retirement plans.

Chapter 3
Bicycle Pumps, Investments and 401(k)s

My father was a man of integrity. However, in his 30s, he was not educated in physics. It was during that time that he told me to help him pump up a car tire. The pump hose was missing the piece that one would screw onto the inner tube's valve stem. It was my task to hold the end of the pump hose on the valve stem. It was through this experience that I learned that increasing air pressure would make things hot. Holding the end of the hose to the stem burned my fingers.

The same principle works with the stock market. A continual infusion of new money into the stock market will heat up the market. For most of the last thirty-seven years this has been happening.

The Revenue Act of 1978 created the 401(k). As mentioned previously, the realization that Social Security could not handle the life style needs of the growing retirement population prompted our Government to provide an incentive to get people to save for their own retirement. This legislation has been hugely successful in getting people to defer current consumption. As of 2008 over 65 million 401(k) accounts had been initiated.

Ironically, this has become a super-sized stock market 'Ponzi' scheme. There is nothing illegal or immoral about this. It is merely the result of the mechanics of the program. Once the 401(k) plans had been set in motion, new deposits were automatically received every month from the weekly withholdings of all these paychecks. It does not matter whether or not there are good new stocks to be bought by the plan administrators, the collected funds are invested in whatever seems attainable.

When an individual chooses to invest, since he is not burdened with the task of placing hundreds of thousands of dollars at a time, he can be patient in selecting his stock. The 401(k) trust administrators do not have that freedom. And since there are many administrators competing for the same stocks, this monthly infusion of cash pushes the market up. This does not mean that a particular stock's true value has gone up. It only means that someone was willing to buy it for a higher price than anyone else.

It follows that many bidders with fresh money to operate with each month create artificial, temporary, market growth. Occasionally there will be a new consensus that will cause the market to drop, usually to rise again. We saw this in 1987, 1990, and early parts of

this new millennium. However, now, in 2016 the first of the 'Baby Boomers' have hit the compulsory Required Minimum Distributions age. This does not need a new temporary consensus to cool the market..

With the surge in Required Minimum Distributions that is expected to continue for eighteen years, the opposite physical principle will be demonstrated. Just as compressing air heats it up, expanding air cools. And in like fashion, with the withdrawals from the market off-setting the infusion of new 401(k) deposits, the market must, at least slow its rate of growth. Investment accounts can be expected fall short of past performance. Stock prices are likely to suffer, negatively impacting retirement accounts.

This reality will affect the real rates of return on retirement plans and some types of life insurance. For this reason it is most unlikely that previously projected 8-10% earnings rates and capital gains can be attained over the long run. Suffice to say, with the retirement of the generation that has driven up the market, this same generation could bring the market down. With this demographic change we cannot expect the same financial performance over the next thirty years as that which has just passed.

This reality serves as a basis for the policy and retirement account comparisons that will follow. There is another reality that can create or diminish wealth. It is the interest generated by the lending of money. This is the engine that powers the concept of **'the magic of compounding interest.'** Where this interest is generated makes a difference. This will be demonstrated in the chapters to come. But before going there it is necessary to determine what one's situation is and what is needed to meet one's goals.

Chapter 4
You'll Spend a Fortune

If you have space on your credit card or money in your checking account, can you say 'no' when you see something you want? Have you calculated what your retirement income would be, based on what you are saving now? Sometimes all that is needed to change one's buying and saving habits is seeing what is being spent, and asking whether it is really necessary. The government has created programs to encourage us to save, but the decision to do so is ours.

This chapter will help you define where you are financially and give you the tools you need to evaluate the long term consequences of current financial choices. In planning a trip, in order to know how to get where you want to go, you need to know where you are. Figuring out your financial road map requires the same information.

The Life Underwriters Training Council, which is an education partner of the National Association of Insurance and Financial Advisors, has offered a model cash flow form which we are encouraged to share with the public. I have adapted this to reflect the purposes of this report. In the appendix at the back of this report I have included the cell contents that you can use to create your own spreadsheet template. This template, should you choose to use it, will automatically calculate your monthly income and expenditures, and tell you what you have left over for savings. On the next page is a sample of this budget analysis form.

Monthly Income	
Primary Income	4,000
Secondary Income	2,100
Commissions	
Interest	85
Dividends	135
Rental Income	
Royalties	
Social Security	
Pension Benefits	
Annuities	
Total Income	6,320

Outstanding Debts	
First mortgage	275,000
Second mortgage	
Card	3,000
Card	500
Card	
Auto	23,000
Auto	
Personal	7,000

Debt Recap	
Long Term Debt	275,000
Short Term Debt	33,500

Assets	
Home Equity	-43,000
Income Property	
Investments	
Bank Accounts	9,455
Retirement Funds	250,000
Life Insurance	500,000
Life Insurance	125,000
Disability Income	
Disability Income	

Outlay	
Tithes & Offerings	500
Housing (rent, mortgage)	2,600
Telephone	200
Electric & Gas	175
Water and trash	85
Internet	40
Food	400
Clothing	50
Debt Payments	335
Entertainment	80
Car Payments	269
Gas & Oil	280
Car Maintenance	80
Medical/ Dental Care	70
Auto Insurance	120
Home Insurance	Included
Health Insurance	275
Disability Insurance	
Life Insurance	168
Income Taxes	350
Property Taxes	Included
Business (Schedule C)	
Retirement Savings	100
Retirement Savings	
Investing	
Emergency Savings	75
College Savings	
Miscellaneous	
Total Outlay	6,302

Cash Flow Recap	
Income	6,320
Outlay	6,302
Difference	18

By filling out the form on page 9, you can discover where adjustments may need to be made. Once you have determined where you are, you can better set goals to assist you in successfully arriving at financial independence, a time when you can decide whether you want to remain a full or part time producer or become a net consumer. However, you cannot simply take the previous page and expect it to match your needs at retirement. Some of the items in that page will be or should be resolved. But others will have been changed by inflation.

It has been said by some that inflation is the result of the increase in the money supply without a comparable increase in goods and services. I believe a simpler way to perceive inflation is that things just cost more than they used to. While it is not my intention to explain all causes of inflation, I suspect some inflation is engineered by governments to pay off debts with currency that is of less value than at the time of the original loans.

Over the last one hundred years the rate of inflation as tracked by the yearly changes in the Consumer Price Index has ranged as high as 18%. Only thirteen times during that period has the CPI gone down. See Appendix page 4 for a brief illustration of increases in the cost of living. The last twenty-five years inflation has averaged close to 3%. If this were to be the average annual rate of inflation over the next thirty years, living costs that are $2,500 per month now would be $6,068 then. The total spent over that thirty years could be $1,400,000. Assuming that Social Security at retirement covers half of the monthly need, it would be reasonable to strive for an income producing base of $1,000,000 at retirement.

Here is a fact that most people are not aware of: In order to counter the loss of value due to anticipated inflation, lenders must calculate the interest they must charge to net a true gain on the money lent. Interest on loans reduces actual purchasing power for goods and services. Higher interest on loans may reduce the standard of living for borrowers, but it also generates higher interest to those who have deposited their funds with the lenders. This higher interest discourages stock market investing, thus creating a drag on the stock prices.

The extremely high national debt, along with the impending ‘Baby Boomer’ effect, points to interest generating instruments as being more productive in the future than traditional investments. These interest rates may be higher than they are now, but it is not wise to rely on life insurance cash surrender value or retirement investment projections using rates that are unavailable today

Several popular books on life insurance had been making projections in the 8-9% range. Since these books contained good information, it is reasonable to expect the typical reader to believe that these rates will happen. In some cases they might, but not for a favorable reason. The cause likely being inflation, the actual purchasing power is diminished. Therefore, it is necessary to identify what is true today and build on these ideas with real

current numbers.

One fact that has been substantiated by our Federal Government is that properly funded permanent life insurance is a good vehicle for long-term savings. The after-tax yield has been significant enough to cause regulations limiting how much you are permitted to pay into a permanent life insurance policy. However, life insurance's first function is to meet the financial need created by the death of the insured. **A good long-term yield is of limited value, if the Death Benefit is not sufficient to protect the needs of the beneficiaries.** Saving for retirement is a long-term project and if a producer dies too soon there should be the instant creation of an asset to replace the lost income.

So, how do you determine the amount needed?

The best way to figure this out is to add up those expenses that are due at death and calculate the principal needed to provide the monthly income. Using the form on page 9 as a model for this process, you can come to a reasonable conclusion of what is needed. Added to that example, for illustration purposes, I will assume that the insured has a $10,000 out of pocket limit on his health insurance, and other end-of-life expenses come to $12,000, and the mortgage is maintained. Other fixed expenses, such as gasoline and clothing, might be reduced by 25%. Also assumed, at 3% interest, the principal needed to produce $100 per month is $40,000.

Medical expenses and burial	$22,000
Short-term debts	33,500
Monthly fixed expenses of the beneficiary	4,055
Minus on-going monthly income	2,320
Monthly income shortage	$1,735
Principal needed to generate additional income	$694,000

The $694,000 is the result of multiplying 17.35 by $40,000. With the $55,500 for medical expenses, burial costs, and short term debts added to the principal needed to make up for the income shortage, the total in this example comes to $749,500. In this case, subtracting the $500,000 of life insurance already in place, $250,000 in retirement funds, and the bank account, the goal of maintaining the beneficiaries' living standard has been met.

Though a 3% yield on the principal for the beneficiaries seems low, this is a sound interest rate, not only because that is what the bank CDs had been earning when I started this report, but also by not spending the earnings in excess of the 3%, one has a built-in hedge against inflation. This is not a perfect solution for dealing with inflation, but it may be the

easiest.

For example suppose you had $100,000 earning 7% interest, and you retained the 4%, the following year the principal would be $104,000, which at 3% would generate $3,120 of annual income as compared to the $3,000 paid out the year before. Each year that your income account earns more than the 3%, you would adjust the next year's withdrawals to reflect 3% of the new balance.

Depending on where you have the money, you could have this growing principal taxed on only the interest withdrawn. This will be addressed in a later chapter when discussing annuities.

The next chapter will describe the different types of life insurance, and how they work. To hear some people's comments, you might get the idea that only one product is right and all the others are scams. Once you understand these policies, I believe that you will gain a better idea about what is right for you.

Chapter 5
The Life Insurance Choices

Do not classify the words or deeds of your opponents as being hateful, malicious or criminal in nature if they can also be easily characterized as simple ignorance or gross stupidity. Anonymous

You are now entering the battle zone. This is where confusion reigns, and well-meaning people with misunderstandings have for years maligned the integrity of others. The primary battles have been over Term Life versus Whole Life insurance. But both of these as well as other forms of life insurance have value when properly applied. Therefore, whether a person says that Whole Life (WL), Universal Life (UL), or Term Life insurance is the only product to buy, he is showing that his education has been limited.

There was a time that I thought Term Life was the only way to go. While I still offer Term, I recognize its limitations, but WL and UL also have weaknesses. This chapter will describe the benefits of each and show where each has the advantage over the other.

Just as life insurance comes in many forms, there are many ways to pay for it. For example a man, aged 40, who is in good health and does not smoke, could buy a life insurance policy for $500,000 for a single payment of $115,000. At the other extreme, he could make a monthly payment, referred to as premium, starting at $34.31. In either case, or somewhere in between, as long as the required premiums have been kept up to date, the insurance company would pay to whomever the insured had named as the beneficiary the $500,000.

In describing the various policy types, when referring to risk, I am writing about the risk that the insurance company is taking on that the insured might die during the period of coverage.

Term Life

Without question, this is the easiest life insurance to pay for when first acquired. And it is the least difficult to explain. The essential description of Term Life insurance is that you are paying premium for a Death Benefit that will be paid if you die during that period of time for which the premium applied. Should you stop paying the premiums, the coverage ends, and you get nothing back.

With Term insurance, since there is no cash surrender value, it also is the easiest to compare premiums –Term versus Term (in the beginning). When shopping for this type of insurance, it is important to look at the renewal premiums as well as the initial premiums, since it is usually desirable for the policy to be renewable beyond the initial term period.

There are, however, some Term policies that clearly are not meant to go beyond the contracted period. Because these policies are limited and not guaranteed replaceable by a policy with a longer benefit period, the premiums will be lower. If one is shopping price without being aware of this limitation, he could be getting a policy that will not meet his long-term needs.

The best argument for Term life insurance is that it is a lot easier to acquire the full amount needed when the applicant cannot afford to purchase a level premium permanent policy for the proper benefit amount. However, for those who can set aside the premium for Whole Life or Universal Life, the long-term benefit of one of these will be better than 'Buy Term and Invest the Difference' (BTID). This will be demonstrated by comparing a Term contract with a side fund to a competitive Whole Life policy.

Term life insurance is extremely important for those who have a temporary need or a temporary budget. It is better to have bought this insurance than not to have any, or to have an insufficient amount simply because the needed amount, if Whole Lif**e,** would be unaffordable. But be aware that over time, Term premiums can become higher than Whole Life's, **and should a Term premium be missed after the insured's health has failed, that policy will be cancelled. And it will not be recoverable.**

Typically, the original premium for the Level Term insurance is guaranteed for a specific period of time, such as ten, twenty, or thirty years. Then at the end of the initial period, to continue the Term policy there is a projected increase in premium, as well as a guaranteed premium that could be much higher. For example, a $500,000 Twenty Year Level Term on a 30 year old male non-smoker might be $395 per year till age 50. Then at age 50, the renewal premium could be projected at $2,305, while the guaranteed premium might be $5,880 per year.

I, personally, have not seen such policies renewed at the higher guaranteed premiums. However, if the insurance company is so inclined, it could choose to charge a renewal premium higher than the original projection.

Term insurance has often been compared to renting a house, in that as with rentals, most Term policies build no equity or surrender value. However a few companies have come out with Return of Premium (RP) policies. These have a higher annual premium than those

without such a benefit. Assuming that the insured keeps the policy for the entire specified period, the refunded premiums equate to a good rate of return for the difference between RP term and those without this feature.

Some need for coverage may be permanent, and Term insurance, over time, becomes more expensive than Whole Life. A point is likely to be reached at which the policy owner may wish to switch to a Whole Life policy, but due to a lingering health problem the insured may be ineligible for a new policy. Most Term life insurance policies are issued with the provision that, at least for a period of time, all or a portion of the Death Benefit can be exchanged for a permanent life insurance policy without the need to verify that the insured remains in good health. This is called a Conversion Provision. Some companies, if the original policy contained a waiver of premiums during disabilities longer than six months, will convert the Term insurance to Whole Life, and waive (pay) the premiums for the remainder of the disability.

The purest form of Term insurance is Annual Renewable Term. ART premiums increase yearly – as the insured gets older. As with the other Level Term products, the premiums at advanced ages could make affordability a problem. Some companies, as a response to these higher costs at older ages, allow the policy owner to change the coverage to a form of Decreasing Term for which the premium remains level. Each year the Face Amount of the policy reduces to what that premium could buy at the higher cost per thousand.

ART also is the idea behind the creation of Universal Life policies, the next policy type to be described.

Universal Life

One of the mistakes made by those who champion ‘Term life only’ is the belief that it is impossible to create a level premium permanent life policy that is as cost effective as Term. It may be that this misconception is because of the confusion between the words ‘premium’ and ‘cost’. With Term insurance, for the policy owner, the premium is the cost, but for those purchasing Universal Life, the premium includes both cost and deposit to an accumulation of cash surrender value.

The cost portion of the UL premium is made up of administrative expenses and mortality charges. These mortality charges are comparable to the yearly increasing costs for the Annual Renewable Term policies referenced in the previous section. To better understand how a UL policy works, imagine that the UL policy looks like a community water tower. The capacity of the tower represents the promise to pay when the Death Benefit of the UL is due.

The water tower has two intakes, one representing premiums paid and the other the interest being earned by what is already in the tank. At the base of the tower is a valve that determines how much of the contents of the tank is to be released each month. Each year the valve is opened a little more, representing the increasing cost per thousand of the risk that the tank must deliver.

If the premium poured in at the top matches what is coming out at the bottom, that is similar to ART premiums. If more is going in than what is flowing out as costs, the tank begins to fill. Once it begins to fill, the contents generate interest, which adds to the content of the tank. (This is not assured with Variable Life, which will be discussed later.) If the policy has a level Face Amount, that is, no matter how much is in the policy, it will pay the original Face Amount, then as the contents (the accumulation value) increase, the amount of risk to be charged for decreases. For example, if the Face Amount is $500,000, and the accumulation value is $100,000, then the risk that must be charged for is $400,000.

In this example suppose the interest earned on the accumulation value is 4.25% and the annual cost per thousand of risk in that year is $7.00. The interest earned inside the policy would be $4,250, while the mortality charges would be $2,800 (400 x $7.00). In this case the accumulation value would have increased by $1,450, even if no premiums were paid in that year.

Since the $4,250 of interest had been generated inside the policy, no income tax would have been due, not even on the interest used to pay the $2,800 for the mortality charges. This fact alone makes UL less costly than Term, since the person paying the ART premium from earnings from a side fund, if in a 30% tax bracket, would have had to receive $4,000 in earnings to cover the same charges.

Universal Life has a flexibility that does not occur with many life insurance products. One such benefit of this flexibility is being able to increase or decrease the Face Amount of the policy. If one's needs increase, and he is still healthy enough to qualify for additional insurance, he can add to his coverage without having to get an additional policy. On the other hand, he can increase his premiums (up to Federal limits) or decrease his premiums, according to his changing circumstances.

As in the example above, he can stop paying premiums for as long as there is sufficient accumulation value to cover future costs. This is both a strength and a weakness. As with ART, the cost per thousand for the risk is going up yearly. If the policy owner does not keep enough going into the policy, there is the danger that the policy could lapse. It is important to monitor these policies yearly to make sure changes in interest do not undermine

their financial integrity.

Policies of this type have had interest earned as high as 9-12%. Current interest rates on the traditional UL policies are now in the 4.00-4.25% range, This is still a competitive rate of return, but if one has a policy that had been originally projected at the higher interest rates and has not adjusted the premiums to offset the reduced interest currently being paid, the policy may not last till the insured passes away.

It was previously mentioned that one could increase the premiums paid into these policies. It was also mentioned that the Federal Government has placed limits on how much could be paid into these policies. You might wonder, if there is enough accumulation value in the policy to maintain it for life, why would anyone want to pay in more, and why does the government limit what can be paid in? The answer to these questions will be in chapters that deal with how to take advantage of the secondary benefits of Universal Life and Whole Life policies.

As with Term there are variations in Universal Life. One such variation is the Death Benefit being the initial Face Amount plus the accumulation value. If the afore mentioned example had had this option, the Death Benefit would have been $600,000. The mortality charges for that year would have been $3,500, in which case the accumulation value would still have gone up by $750. And the Death Benefit would also have increased by that $750.

Relatively new to the Universal Life family is Equity Indexed Universal Life (EIUL). This product integrates the traditional UL with interest calculations based on annual gains in the stock market. Basically, if the market goes up, interest is determined by those gains, up to a cap. At the present the caps (maximum interest) have been in the 10-12% range. These caps are subject to change. The attraction of EIULs is the possibility of stock-market-like gains without stock market losses. In those times in which the market goes down the accumulation value does not go down with the market.

Current sales illustrations are showing projections in the 6-7% range. The problem with these illustrations is that they are based on a demographic that is in transition. Chapter 3 raised a warning that should not be ignored. More on this policy type will be commented on when dealing with secondary benefits of permanent life insurance.

Another version of Universal Life that has been available much longer than EIUL is Variable Universal Life (VUL). This product might perform better in an upward movement of the stock market than either the traditional UL or the EIUL, since its gains are not as limited, but it also is not protected from stock market losses. Its structure is similar to UL, but its accumulation value is like that of mutual fund accounts.

This product, when marketed, must be presented with a prospectus, a pamphlet that discloses potential risks. VUL shares the same risk for the policy owner and performance potential as 'Buying Term and Investing the Difference (BTID)'. This is a good choice for those who have the means to purchase Whole life insurance, but are not satisfied with its more conservative performance. It has the same performance potential as BTID, but it retains the tax advantage of Whole Life and traditional UL.

One must keep in mind that there is no certainty of a gain with VUL. The accumulation value in this type of policy can erode. This was recently brought home to me when I was asked to provide expert testimony in a suit against an agent who sold a VUL to a family for estate tax considerations that over the course of eleven years totally consumed an outlay of $650,000.

For an article that provides a heads-up on Variable Life risk, go to http://www.prweb.com/releases/2009/04/prweb2340994.htm

Whole Life

The 'Grandfather' of permanent life insurance is Whole Life (WL), sometimes called 'Straight Life' or 'Ordinary Life'. There are three types of Whole Life: Guaranteed, Participating, and Current Assumption. What these policies have in common are level premiums based on long-term mortality and rate of return assumptions, guaranteed Face Amount, cash surrender value approximately the same as the Face Amount at maturity, and loan value prior to maturity.

Maturity for policies issued prior to January 2009, depending on the company and the product, typically was the anniversary nearest ages 95-100. Now, all new policies are required to have a maturity age of 121. For tax reasons, this is very good news.

When I was first recruited into the life insurance business, I was shown a newspaper article about a person receiving a check for the Face Amount of his policy at age 95. He had out-lived his policy. His was a Participating WL policy, and because of his company's experience over the many years he had the coverage, there was much more in that check than what he had paid in premiums. In my naiveté, I thought this was great. I was unaware of the tax consequences. When we get to discussing policy loans, you will see why the later age for policy maturity is so important.

Guaranteed Whole Life's premiums, Cash Surrender Value, and Face Amount are all set at the time of issue. Whether economic conditions improve or deteriorate, whether the

company's claims experience gets better or worse, the values in these policies do not change from what was originally projected. This type of WL policy is not likely to have as good of a long-term yield as a Participating WL policy, but it will usually have a lower annual premium.

The attraction this policy holds for some is the absolute certainty of its loan and Cash Surrender Value at any point in time.

Participating Whole Life also has guaranteed premiums, Cash Surrender Value and Face Amount; however, it also has returns of premium generally referred to as Dividends. You may encounter companies that call these 'Credits'. Par WL guaranteed premiums and values are based on a 'worst case' scenario. However, it is the expectation that these companies will have better experience than what supports these guarantees. Historically, Par companies have done better than their guarantees. **But, dividends are not guaranteed.**

These dividends can be used to reduce premiums, accumulate at interest, buy Paid-up Additional Insurance, and depending on the company, several other options. The most frequently advised dividend option is Paid-up Additional Insurance. I agree with this recommendation, since it enhances tax-deferred compounding of gains.

The main attraction Par policies have is the opportunity for greater Cash Surrender Value, and an anticipated better Internal Rate of Return. The problem with Par policies is shopping projections, trying to find the best. As with stock market investing, past or present performance is no guarantee of future results.

Current Assumption Whole Life (CAWL), the flip side of Par WL, is generally called 'Interest Sensitive Whole Life'. This is a simplification that leads to misunderstanding. These products are interest sensitive, but they also are mortality experience sensitive. CAWLs are similar to traditional ULs in that current premiums are based on current economic and mortality experience. The difference is that these will have premium changes as interest and expenses change. CAWLs are monitored more closely than ULs, and therefore are less vulnerable to underfunding.

The attractions CAWLs have are lower initial premiums than Par WL and earlier build-up of accumulation value when premiums match that of Par products. Even though CAWLs clearly state that they are not Participating policies, competition encourages the CAWL companies to be competitive with Par companies.

Whole Life products and many Universal Life policies as well, have Term Riders that can piggy-back on a permanent policy base. By adding Term life insurance as an additional benefit to a permanent life insurance base, one does not have to choose too little protection to have Whole Life coverage or only the ultimately more expensive Term insurance.

For example, if the couple on page 9 were 35 and 32 when they purchased their life insurance, and these were Current Assumption Whole Life policies, their monthly premium could be approximately $380 per month. As 20 Year Level Term insurance, the monthly premium could be $60 per month. By having a $300,000 Term Rider on the husband and $125,000 on the wife on a base of $200,000 permanent insurance on the husband, the premium is $168 per month, a premium that is easier to budget while making sure there is enough coverage, while having the mathematical and tax advantages of Whole Life insurance.

This chapter has described the main features of the various types of life insurance. It has shown what makes each type useful, and to a limited degree compared the suitability of each type. This chapter closes with a comparison of 'Buy Term and Invest the Difference' with a Participating Whole Life policy with a Paid-up Additions Rider, using current Term premiums and a USBank CD Special Roth IRA.

Male Age 40, non-smoker

Annual Commitment:	$	10,000.00
Tax Bracket:		30.00%
Initial Face Amount:	$	500,000.00
Term Premium, Years 1-20:	$	740.00

Certificate of Deposit Rate: .75% current as of May 2015

Year End	Face Amount	After Tax Surr Value	CD Roth	Term + CD Roth
1	513,151	3,316	9,329	509,329
2	526,127	6,820	18,729	518,729
3	538,935	16,029	28,199	528,199
4	551,590	26,303	37,740	537,740
5	564,107	36,955	47,352	547,352
6	576,493	47,994	57,037	557,037
7	588,765	59,446	66,794	566,794

Year End	Face Amount	After Tax Surr Value	CD Roth	Term + CD Roth
8	600,930	71,314	76,624	576,624
9	612,999	83,685	86,529	586,529
10	624,997	96,574	96,507	596,507
15	695,092	166,098	144,533	647,533
20	782,031	249,821	200,501	700,501

As can be seen on pages 20-21, Term life insurance may be more attractive in the early years. But by approximately the tenth year the over-all advantage has shifted to the Whole Life policy. The point of this illustration is to show that both types of life insurance are right, depending on the situation and goals of the policy owner.

The above is a Participating Whole Life policy with an annual premium of $6,590 plus a Paid-Up Additions rider premium of $3,410. The Death Benefit is increased with additional Paid-Up Insurance funded by dividends. These dividends are not guaranteed. The actual payment of these dividends could be higher or lower than projected.

The surrender value of the Whole Life policy has been adjusted to reflect the effect of income taxes in the event the policy is surrendered at a greater value than the sum of premiums paid. This was done in recognition of the fact that interest in Roth IRAs, if held to age 59 ½, becomes income tax free, while surrendering the Whole Life policy could result in a taxable gain..

At the time of writing this chapter, the maximum earnings rate for long-term Certificates of Deposit at Bank of America in California is .15%. This interest rate, just as with gains in the life insurance policies, is subject to change. It has been this author's goal to make the comparisons fair and balanced. It is possible that interest rates will rise. When this happens, it is likely to benefit both those who have CDs and those who have Par Whole Life, Current Assumption Whole Life and traditional Universal Life policies.

While Term life insurance is only of value when the insured dies, the permanent policies are useful for more than their Death Benefit. The next chapter is the first of several describing some of the secondary benefits of these policies.

Chapter 6
Tax-Free Retirement

Though some books and magazine articles suggest that you can get a tax-free retirement by way of life insurance policy loans, in most cases it is not true. While I was in the process of writing an article for InsuranceNewsNet Magazine on this belief (April 2009 issue), I received a query at AllExperts.com from a retired business owner that illustrated exactly what I was writing about. Since his experience is so dramatic, I am including his story.

At the time he wrote to me he was 79 years old, not in the best health, and living on limited income. Approximately twenty-five years earlier, he had purchased a Whole Life policy for a single premium of $100,000. The purpose of this policy was to provide an annual income of $6,000 in the form of yearly loans for as long as he lived.

After twenty-four years he received a letter from his life insurance company stating that all the cash value of the policy had been borrowed out. He was warned that if he did not pay back some of the loan, the policy would be canceled. Not realizing the seriousness of letting the policy expire, he chose to not repay part of the loan. The policy was terminated for non-payment, a very expensive event.

Upon termination of the policy, the insurance company sent him a taxable income statement (Form 1099) for $235,000. In other words, all of a sudden, he owed taxes on his limited income plus on 85% of his Social Security for that year, and that $235,000. I sure hope that he owned his home and had not yet used it for a reverse mortgage. Based on what he told me, that is the only way he would be able to pay the income taxes due.

When he purchased the policy that put him in this hole, he had not been properly advised by the agent who sold it to him. And there is little likelihood that the agent is around to provide financial relief for this error. The company that sold him the policy had been absorbed by another company years later, which had taken on the responsibility of the yearly loan of $6,000 – until the loan value had been used up.

So, how did this happen?

The answer is technical. But the possibility of this happening is so real, that this must be understood by anyone who purchases life insurance for retirement income, so that he will

not fall into this pit. First one needs to understand the four ways one can benefit from Whole Life and Universal Life policies.

1. The Death Benefit
2. Cash withdrawals
3. Loans
4. Guaranteed income

Explanations

1. The Death Benefit is available once the first premium has been received by the insurance company, and the applicant has been approved for the coverage, and the policy has been delivered. This benefit is not income, so there is no income tax.

2. Cash withdrawals from life insurance policies are first returns of the cost basis unless the policy is a Modified Endowment Contract (a term that I will explain later). Until the amount withdrawn is greater than the premiums paid, there is no income tax. Withdrawals beyond that point are taxed as income.

3. Loans, under current tax law, are not taxable while the policy remains in force.

4. The guaranteed income, called Annuitization, may be for a set number of years or for the rest of one's life. The periodic payment of income is taxed on the difference between the income received and the sum of premiums paid divided by the expected number of periodic payments. For example: supposing that the insured had paid $3,000 per year for thirty years, and he is expected to receive monthly payments for fifteen years. $500.00 of each payment would be untaxed return of cost basis. If this were to be a lifetime income, and he lives longer than the anticipated period, the full monthly income from that point on would be taxable.

Policy loans are the secondary benefit that may be the most often used, and the one that can create the tax problem. Years ago, as long as certain requirements had been met, one could borrow on his life insurance policy for any reason, and the interest paid on that loan would be deductible against other income, thus reducing income taxes owed. In the 1980s that was changed. Now, if the loan is considered to be a consumer loan, the interest is not deductible.

When anyone borrows on a life insurance policy, he is borrowing the insurance company's money. The cash value of the life insurance policy remains in the policy,

continuing to generate untaxed interest. The insurance company charges interest for the use of its money, adding any unpaid interest to the loan. As long as the policy remains in force, the money borrowed, even if it is more than what had been paid in premium, remains untaxed.

Properly planned, it is possible to generate a lifetime income via these loans that remain untaxed for as long as one lives. Then, at death, the accumulated policy loan is paid off out of the proceeds from the life insurance policy. Since the Death Benefit is not subject to income taxes, this makes the money borrowed for retirement income-tax-free. However, if one is too aggressive in borrowing, the loan balance could exceed the accumulating value in the policy, itself. When that happens, the policy lapses.

In the case of the 79 year old, the accumulation value of the policy had gone from $100,000 to $335,000. While the companies had sent him a total of $144,000, the interest on the yearly loans had created a loan balance of just over $335,000. Had he died before the policy lapsed there would have been no tax, but since there was no Death Benefit generated, the loan interest was not deductible, and the full $235,000 of unreported interest became taxable.

Because he let the policy lapse, in addition to the tax on the $44,000 he received in excess of his original premium, he was taxed on $191,000 of phantom interest. This could have been avoided had he adjusted the size of the yearly loans downward to reflect the falling interest earnings over that twenty-five year period.

The moral of this story is: Policy loans are not tax-free. They are merely untaxed. And they remain untaxed, if the insured expires before the policy does. Carefully using loans to generate untaxed income will result in tax-free income when the loan is paid off by the death of the insured.

Even if life insurance is not needed, properly funded life insurance, properly drawn on at retirement, has proven to be more productive than bank savings. So, saying that one will do better simply by putting money in the bank is verifiably wrong. There is, however, another tool for tax-free retirement income.

Since January 1998, Roth IRAs, and more recently, Roth 401(k)s may have become better financial products than life insurance for pure accumulation for tax-free retirement income. Roth deposits, just as life insurance premiums, are composed of income that already has been taxed. Their earnings grow tax-deferred. Then after 59 ½, and a minimum of five years from the inception of one's in force earliest Roth IRA, all distributions are tax-free.

For 2014, if one is single and earning less than $114,000 per year, the most one

can put into a Roth IRA each year is $5,500, or $6,500, if over age 50. That is, if the Roth depositor has income of at least the amount to be deposited. If one is married, and there is only one bread-winner, there can also be a Spousal Roth IRA. A married couple can earn up to $181,000 per year and still be able to contribute fully to Roth IRAs. These thresholds may be lower, if one also has a company-sponsored retirement plan.

If there is a reason to do so, one may contribute to both the traditional tax-deferred IRA and Roth IRAs. However, the combined annual contributions cannot exceed the previously mentioned limits.

The life insurance industry offers a savings product well-suited for Roths. These policies are Annuity contracts. Until 1998 their advantage was limited to tax-deferred growth. Taxation would not take place until interest was withdrawn. By having the annuities in Roth IRAs, what had been merely tax-deferred earnings, becomes tax-free earnings when received after 59 ½. The advantage that annuities have over life insurance is the lack of mortality charges found only in the life insurance contracts. Go to Chapter 11 for more information on annuities.

For those who have maxed out their Roth IRA contributions, traditional annuities are still useful for tax-deferred growth along with permanent life insurance. Permanent life insurance, because of the similar tax-deferral growth as annuities, can also serve other secondary purposes that will be discussed in the following chapters.

Chapter 7
Home Equity Management

Symbiosis is a word I learned in my tenth grade science class. It is the cooperative relationship of two different organisms dependent on each other for their common survival. The last several years have demonstrated how symbiosis might have prevented many of the foreclosures that have taken place, and in the process could have minimized the concurrent loss of home values.

Symbiosis is also the opposite of what has been taught as common sense. What has been encouraged is to pay extra on the loan principal. The popularity of this idea has created companies that charge for the convenience of making twenty-six half-monthly mortgage payments per year. The rationale has been that by making payments ahead of schedule, less interest is charged and the mortgage is paid off years sooner. For many this has proven to be a very costly mistake.

For years I have advised people to reject this payment strategy. My reasoning has been sound, but at the time I realized the risk involved in this common practice, I had no idea that we were heading into the 'perfect financial storm.' It had not entered my mind that concurrent to a time of massive job losses there would also be such extreme drops in home values.

On June 4, 2015, in a conversation with Jason Bock, a representative of a national mortgage loan company I was surprised with his endorsement of this chapter's warning. I submit it as he stated it:

"As I told you looking for different mortgage terms it is the lower term mortgage options (15 years or less) that have the highest foreclosure rates.

The reason for this is because people over extend themselves for two reasons. #1 they are chasing low interest rates and are more rate focused than anything else. This clouds their judgement when selecting loan options. #2 They are not accounting for the future. Things change as time goes on such as income that is coming in and debt obligations going on. They are not anticipating negative changes to take place in their situation and have over extended their mortgage payments."

Two things that I believe are important to most of us are a home to call our own and financial security. Whole Life insurance is one of the elements of financial security, but not just for guarding against the economic effects of a death. Through proper budgeting with life insurance integrated with the scheduled payment of one's mortgage, anyone can pay off the

mortgage early, if he chooses to. And in the process of funding the mortgage payoff this way, the home buyer is keeping the full mortgage interest deduction that would have been diminished by reducing the principal ahead of schedule.

However, not all permanent policies are appropriate for this purpose. Life insurance policies that gain their interest from debt paper, such as corporate or government bonds and mortgages, are better suited for integration with mortgage management. Variable Universal Life and Equity Indexed Universal Life do not meet this qualification. These two are dependent on upward movement in the stock market. As introduced in Chapter 3, the market is vulnerable to long-term negative influences brought on by the Required Minimum Distributions that come into play as the 'Baby Boomers' reach age 70.

Assuming that a home buyer qualifies for a 5% mortgage loan rate and is in a tax bracket of 30%, the mortgage interest after receiving the benefit of the mortgage interest tax deduction would be 3.5%. This has been less than the interest earned in most competitive traditional WL and UL policies. This is one of the reasons that it is wiser to put only the minimum payment into the mortgage. A home buyer may actually make more money by stretching out the house payment, than by paying down the loan ahead of schedule.

But there is a more important reason to do this, as we learned from the storm we have recently experienced. Many of those who have paid thousands of dollars in advance lost that money, when they lost their jobs and their homes had become worth less than their mortgage balance. And here's an eye-opening fact that was brought out by Douglas Andrew in *Missed Fortune*: Those who have the greater percentage equity remaining in their homes are the first to be foreclosed on**. So, by having paid extra, they increased the likelihood of foreclosure.**

Even though a fifteen year mortgage may have a slightly lower interest rate than a thirty year mortgage, or even a forty year mortgage, I recommend the longer mortgage periods with the difference in the monthly obligation accumulating as an emergency fund in a life insurance policy or the life insurance combined with a Roth IRA. A Roth IRA by itself could work, but it lacks the immediate benefit that the life insurance would provide in the event of the mortgage payer's death. By having these working together the home is made more secure, and if these are not needed to pay off the mortgage, they can become a source of retirement income.

An additional benefit of combining life insurance and Roths with a fixed interest rate mortgage is that during a time interest rates are rising the mortgage rate will remain as originally contracted, while the interest generated in life insurance policies and Roths could

be increasing. By making larger payments to the mortgage company, you get no benefit from increasing interest rates. I must repeat, Variable and Equity Indexed Universal Life may not gain the same advantage as the other permanent policy types. What follows is an example of how 'home equity management' works with a combination of a Roth IRA and life insurance.

Ted and Fred Parker, identical twins who have always sought ways to stay close, each bought $350,000 homes in the same neighborhood. They both negotiated thirty year Fixed Interest mortgages at 4.75%, and they each put 20% down in order to avoid the Mortgage Insurance premiums being added to their monthly payments. They both wanted to have the mortgage paid off in fifteen years, but they liked the convenience of being committed to the lower thirty year monthly payment.

The thirty year monthly payment of principal and interest on the $280,000 mortgagewas $1,454.85. Ted, exercising his math ability, calculated that he would be spending $523,747.35. On the other hand, he observed, by paying $2,169.84 per month he could pay off the mortgage in fifteen years. In the interim, his required payment would remain the contracted $1,454.85. By committing to the larger monthly payment, his total payments over fifteen years would be only $390,481.63. To Ted, this seemed like a savings of over $133,000.

Fred liked the numbers that Ted came up with, but he worried about the possibility that at some point he might not be able to pay even the lower monthly obligation. He also considered the risk to his family that he might not be around to pay off the mortgage. Fred decided to commit to the same monthly budget, but he made one simple change. At the advice of his life insurance agent, he took the difference between the two monthly mortgage payments, and applied $714.99 to a Roth IRA and a decreasing Face Amount Whole Life policy.

At the end of the first year, Ted's mortgage balance had reduced by about $13,100, compared to Fred's mortgage balance reducing only $4,300. But Fred had a Roth accumulation sufficient to make 4 ½ monthly payments in an emergency. By the end of two years, Ted's mortgage balance was $18,000 less than Fred's. However, Fred's emergency reserve had grown to over $13,000, enough to make nine house payments; and Ted, seeing this and realizing that he had no financial cushion, began to get nervous. Had Fred made the wiser decision?

The following illustration is not guaranteed. All figures are based on what can be done at the time of the writing of this chapter. There is the possibility that interest rates on the Roth IRA and life insurance could go down. But there is also the possibility that these interest rates could rise. What won't change during the mortgage period would be the mortgage interest.

It is likely that anyone using this concept would apply the entire tax refund on the mortgage interest into the Roth IRA or life insurance, but for comparison purposes, only the difference in income tax refund is being added to the $714.99 per month.

Illustrated for: Fred Parker, age 40, non-smoker, in the 30% tax bracket

Roth IRA Interest: 4.0%

End Year 1

15 Year Mort Bal $266,882

30 Year Mort Bal $275,679 Tax Refund Diff $67 Roth $6,705 Life Ins CV $0 Gross Reserve $6,705

End Year 5

15 Year Mort Bal $207,723

30 Year Mort Bal $256,195 Tax Refund Diff $618 Roth $37,770 Life Ins CV $6,776 Gross Reserve $44,546

End Year 10

15 Year Mort Bal $116,113

30 Year Mort Bal $226,203 Tax Refund Diff $1,472 Roth $88,092 Life Ins CV $17,884 Gross Reserve $105,976

End Year 15

15 Year Mort Bal $0

30 Year Mort Bal $187,780 Tax Refund Diff $2,553 Roth $154,862 Life Ins CV $32,246 Gross Reserve $187,108

End Year 25

15 Year Mort Bal $0

30 Year Mort Bal $77,871 Tax Refund Diff $1,194 Roth $39,931 Life Ins CV $46,658 Gross Reserve $86,579

In this example, at the end of fifteen years, cashing out the Roth IRA would result in a penalty on the accumulated interest, since Fred Parker would be under 59 ½. Therefore, he would make the mortgage payments from the Roth IRA as they become due. He would not be tapping into the untaxed interest until year 23, at which point, his being past 59 ½, the interest would be free of taxation and penalties.

At the end of twenty-seven years the mortgage balance would be $48,917. At that point he could pay off the balance of the mortgage with the remaining $8,661 in the Roth IRA and $40,256 from the Cash Value of the life insurance policy. Were he to cash out the

life insurance policy, he would have income tax of about $6,000. After the tax he would have netted about $4,600 that his brother, Ted, did not receive for the same outlay.

In summary, both brothers budgeted the same monthly outlay through fifteen years. Fred planned his payments to be paid over the longer period. Because of this, Fred received greater mortgage interest tax refunds. As a result, he had sufficient funds to cover the cost of the life insurance, made all mortgage payments after fifteen years from the Roth IRA and his life insurance policy, and had money left over. But most importantly, he was comforted by the fact that funds would be available to make mortgage payments in the event of his passing or lack of income. In addition, he had protected his financial liquidity from the loss of the market value of his home.

Next is what I consider the most profound secondary use for life insurance. Following that will be the exposure of the greatest weaknesses of Qualified retirement plans, such as 401(k)s and IRAs, and how permanent life insurance fixes those deficiencies.

Chapter 8
Using Life Insurance as Your Bank

This is a simple idea that actually works. It has been around for years, but for some reason most financial advisors have not been aware of it. The basic concept is presented in books by Nelson Nash and Pamela Yellen, the most recent being Pamela's *The Bank on Yourself Revolution.* I encourage you to read her book. It is the best I have seen in this field. .

This idea starts with the fact that whatever we want has to be paid for. And there are only two ways to do that, cash or credit. The hard truth is that both cost. Credit can easily increase the total cost of a purchase by more than 30%. Cash requires time and discipline to amass the funds needed. Though this is wiser, it seems that for most people, it is also more difficult to do than buying on credit.

But what if you have the fortitude to postpone gratification in order to get what you really want? Wouldn't it be more beneficial to have someone paying you interest on your money as you are saving for purchasing what you want, rather than for you to be paying someone else interest on their money?

Presuming that you agree with this writer that getting interest is wiser than paying interest, it then becomes a question of where to save. As of April 25, 2015, money market accounts earnings are negligible and Certificates of Deposits' earn approximately 1% or less. You can check what is current at the time you are reading this by going to www.bankrate.com. Mutual funds might do better, but they are too unpredictable to rely on. Over the ten year period ending December 31, 2009, the stock market fell approximately 40%. The Dow Jones Industrial Average did better by losing an average of only about 1% per year during that period.

Another problem to consider is the income tax that must be paid on the interest earned on the money market accounts and the certificates of deposits. You might think that double tax-free municipal bonds would be the answer, but unless they are kept until they mature, you could find that you would be getting back less than you had invested in them.

So, what is left?

The solution is high 'cash value' life insurance. The engine that powers this type of policy is the highest accumulation value inside the lowest death benefit that the Federal Government will allow. It works so well that our legislators put encumbrances on these life

insurance policies in order to make other financial instruments more competitive. The first of these are Modified Endowment Contracts. These MECs are defined as life insurance policies that have received premiums sufficient to have guaranteed the policies to be paid-up in less than seven years.

In an earlier chapter of 'Life Insurance and Retirement – the Unvarnished Truth,' I had written about a $500,000 policy being paid up by a single premium of $115,000. Though not guaranteed, this also would meet the definition of Modified Endowment Contract. Such policies are great for passing on wealth without the recipient having to pay income or capital gains taxes. But they are not practical for creating your own personal lending institution. Go to http://www.massmutual.com/mmfg/pdf/mec_client_guide.pdf for more information on MECs.

The second shackle placed on permanent life insurance policies is the Guideline Level Premium. This figure can be exceeded in some years, but the average premium must fall within this Federal limitation, in order to keep its definition as life insurance. Life insurance premiums must stay within these boundaries to avoid the policies being defined as investments, in order to hold on to the tax advantages that have been assigned to life insurance.

With these two issues adhered to, permanent life insurance is the best tool for creating your own bank. The most obvious advantage is the immediate completion of the savings in the event of the insured's death. But two advantages that many are not familiar with are the convenience of using the policy as a 'sinking fund' for advance planning for unscheduled major business expenses and as a device to shield funds from FAFSA considerations which would have reduced financial aid for college students.

To demonstrate the effectiveness of this approach to financial planning, on the next page I will compare a bank certificate of deposit strategy with a 2015 Participating Whole Life policy. This comparison would also work with properly funded Universal Life policies. Because these are life insurance policies, they have costs that bank savings do not have. Therefore, in the early years, money in the bank will be greater than the available funds in the insurance policies.

In seeing these comparisons, it should be noted that interest earnings in these policies, and the bank CDs as well, will change over time. What is certain is that neither of these is directly affected by stock market losses. Therefore, the point of these comparisons is to establish that these policies are likely to out-perform money in a regular bank plan.

Male, age 30, 30% tax bracket, Annual Outlay: $5,500

Bank ‘A’, as of 4/25/2015: Certificates of Deposit Roth IRA at 1.29%

Company ‘O’: Participating Whole Life, Initial Face Amount $355,000

Year End	Bank ‘A’	Company ‘O’	Year End Death Benefit
1	5,571	1,943	365,923
2	11,214	4,024	376,858
3	16,929	7,468	387,807
4	22,719	12,811	398,750
5	28,583	18,436	409,724
6	34,522	24,507	421,454
7	40,539	31,037	433,841
8	46,633	38,008	446,830
10	59.057	53,398	474,363
15	91,549	96,117	549,692
30	202,505	285,588	805,087
35	244,490	377,835	912,903
40	289,255	490,696	1,040,080

As demonstrated above, it takes time and persistency for the life insurance policies to achieve a competitive edge over bank savings. But once that phase has passed, these policies, if they continue to do as they have in the past, will increase their advantage over bank Certificates of Deposits. Like the race between the hare and the tortoise, these insurance policies, by their steady pace over the long run, are able to finish ahead of the faster starting bank plans.

I applaud Pamela Yellen for her efforts to emphasize this characteristic of Whole Life insurance, just as Nelson Nash did before her. It is not a new concept. Some have refused to recognize it. All the same, it works. Assuming you take my advice and read *Bank On Yourself*, or her new book, *The Bank On Yourself Revolution*, I do have a word of caution

that only applies to her use of Paid-Up Additions Riders. Over-utilization of these riders might inspire the IRS to see these as Modified Endowment Contracts.

Company 'O' illustrations, as with those of other companies of its type, are mandated to show what can be done if the future performance is the same as what can be done now. Though dividends are not guaranteed, the companies offering these types of policies have had a good history of paying dividends. When they are applied as Paid-Up Additional Insurance, the ultimate legacy to the beneficiaries is significantly greater than what would have been received from the typical bank Certificates of Deposit.

It should be pointed out that most Participating Whole Life and Universal Life policies, while more productive than other plans of comparable risk, are not funded in the manner recommended by Pamela Yellen. The usual structure is without a Paid-Up Additions Rider. Pamela's design includes this and Term insurance as additional Riders in order to maximize the premiums without creating Modified Endowment Contracts.

Each of the ideas presented so far have presumed that the policy owner is more interested in the 'living' benefits of life insurance. But it remains that the most important function of life insurance is to provide for the financial loss caused by the death of the insured.

At every age there is the possibility that death or the process of dying will have economic impact. For most of us this will be later in life, when it is likely to impact a survivor's retirement income or create a loss of assets due to care and medical expenses. For some there might be the expectation of estate taxes. According to Social Security Publication No. 13-11871, dated July 2008, by ages 65-69, only 27% of us will have passed from this life. With this in mind, it is reasonable to incorporate this eventuality in an over-all financial plan. For most people, permanent life insurance, as has been described in these last four chapters, is the most productive means of being prepared for that time, while meeting life goals along the way.

The next chapter lays bare the dark side of Qualified retirement plans. It will also demonstrate a way to overcome these negatives. You will learn little-known ways to move funds from your retirement plans prior to 59 ½ without a Premature Distribution Penalty.

Chapter 9
- Fixing Qualified Plans – IRAs

"*The power to tax is the power to destroy."*
Chief Justice of the Supreme Court John Marshall

A corollary to the above quote I learned later. Tax codes could be used to shape social behavior. This is the basis on which Individual Retirement Accounts and 401(k)s, and TSPs for Federal employees, defined as Qualified Plans, were created.

If you have been contributing to one of these, you have submitted to the Federal Government's manipulation of your behavior, believing that you are saving tax dollars. If you ever were in Las Vegas, you probably observed the lights and marvelous architecture of the city. This city has been built on the fact that in the contest between the gamblers and the house, the house wins. Everything you see there is designed to manipulate your behavior. For those who contribute to Qualified Plans, the IRS is the house, and you as a Qualified Plan participant are the gambler. For more evidence of this see the attachment on page 40.

It was late 1974, and I had just been informed that there was going to be a new Government program that allowed workers to postpone paying income taxes on part of their income by depositing it into an account that would not be touched until after age 59 ½. We in the life insurance and retirement business thought this was great news. We believed that most people would be in a lower tax bracket at retirement than while still employed. We also expected that people would jump at the chance to delay paying the income taxes.

At that time the top Federal tax bracket was 70%, so not having to report part of one's income as currently taxable was very attractive. Not knowing the history of the Federal income taxes, I assumed the tax brackets were stable, that there would only be adjustments for inflation. I was wrong!

The Federal income tax, as we know it, was established in 1913. Initially, the lowest tax bracket was 1%, the highest 7%, with the bracket between $100,000 and $250,000 being 5%. Since 1916 there have been many changes in the maximum tax bracket percentage. In 1941, the year I was born, the lowest bracket was 10%, the highest 81%, with the bracket between $100,000 and $150,000 being 69%. The highest minimum and maximum tax rates were 23% and 94%, in 1945. For many years the $100,000 bracket was at 75%.

With this record, no matter what tax bracket you are in now, there can be no certainty

that your retirement tax bracket won't be higher than the rate at which you have deferred your taxes.To see more on previous tax brackets, go to page 4 of the Appendix.

In the past conventional wisdom was that people would be in a lower tax bracket during retirement. More and more this idea has become suspect. So much so, that an alternative approach to retirement funding has become increasingly popular. The real cause of being in a lower tax bracket at retirement is the lack of preparation for retirement. Suppose that you budget in such a way that you are able to remain in the same tax bracket throughout your working years and right into retirement. To illustrate the lack of advantage that postponing taxes has, I call on Ted and Fred Parker to compare a traditional Individual Retirement Account with an alternative plan that is composed of after-tax contributions.
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Ted being the conventional guy he is, chose to invest $5,000 per year into a traditional IRA. Being in a 30% tax bracket, he got $1,500 each year off his income taxes. His brother, Fred, also in the 30% tax bracket, after paying income tax on $5,000 had $3,500 to invest in his alternate retirement account.

Both Ted and Fred invested in the same type of fund, earning an average of 6% per year. At the end of thirty years Ted's IRA had a balance of $419,008.39. Fred's account had $293,305.87, since he had only $3,500 each year to invest. With over $100,000 more in his account than Fred's, Ted felt pretty smug. But look what each had to spend after taxes had been subtracted.

Planning on income for the next twenty-five years at the same interest rate as during the working years, Ted's distributions from his IRA are projected at $30,922.31 per year. At 30%, Ted's income tax on this amount is $9,276.69, leaving him with $21,645.62 he could spend. Fred's distributions from his $293,305.87, being tax-free, for the same period at the same earnings rate is $21,645.62, the same as Ted's after-tax income.

In the above example, both Ted and Fred ended up with the same amount from their retirement accounts to live on after taxes were taken into account. But many are retiring at a higher tax bracket than their average tax bracket while they were working. If you do well, it is possible that you also will be in a higher bracket. Should that happen, you will have less net income than you would have had by paying the taxes on your income as it was earned.

Assuming that these were the only incomes in combination with Social Security, Ted would have to pay income tax on at least half of his Social Security income. Fred would be paying no income tax on his, since his Adjusted Gross Income would be less than $25,000.

So, the first aspect of the dark side of Qualified Plans is confusion. (If I believed our legislators actually knew what they were doing, I would call Qualified Plans a fraud.) When one in a 30% tax bracket deposits $5,000 into an IRA, it may feel like he saved $1,500 in taxes, but all he has done is postpone the tax to a time when he might be in a higher tax bracket. He could pay substantially more income tax than he had 'saved.'

Another shock many have felt is that money lost in the typical Qualified Plan in stock or bond funds, when the market values have dropped, cannot be deducted from current income, since the contribution had not been previously taxed.

Even though only part of the retirement account represents the Government's interest in your IRA or 401(k), you cannot simply withdraw any of it without being slapped with a Premature Distribution Penalty . Once you hit age 70, to make sure the IRS gets its share, if you do not take out as much as the Government mandates, **you will be penalized one half the difference between what you did withdraw and what the IRS says you should have withdrawn.** In other words, if you should have withdrawn $10,000 for that tax year, and only took $3,000 ($250 per month), you would be penalized $3,500 ($7,000/2).

A cruel aspect of Qualified Plans is the taxation at the death of the owner of an IRA, who usually is the primary bread winner. Assuming the surviving spouse is a widow under the age of 60, and the youngest child is over 16, there is no Social Security benefit for her till age 60, other than a lump sum of $255. Without Social Security to replace the lost income, unless there had been life insurance on her husband, it would be necessary to pull money out of his IRA. In the event of death, there would be no Premature Distribution Penalty for taking distributions. However, because of Federal and state income taxes, an IRA valued at $200,000 might benefit the widow less than $140,000.

Here's a fix. Unknown to most people is a provision in the tax code that permits periodic distributions prior to age 59 ½ free of the Premature Distribution Penalty. In other words, it is possible to begin taking scheduled withdrawals from one's IRA at any age. These withdrawals can be used for any purpose, however the most appropriate use of this provision is to fund life insurance. An illustration starting on page 5 of the Appendix will show how this can work, and why you might want to take advantage of this IRA feature.

Section 72(t) of the Internal Revenue Code provides IRA participants the opportunity to move funds out of their IRAs at any time prior to age 59 ½, subject to only income taxes. The Premature Distribution Penalty does not apply. There are three ways to fulfill the spirit of the regulation. The first is to convert the IRA into an immediate level periodic income for the rest of your life. This is called Annuitization. There might be a time when this is a good choice, but not times like now, while interest rates are so low. Negatives with this option are

loss of control of the asset and an unchangeable periodic payment that ends with the death of the beneficiary of the annuity, even if that happens one month after initiating the income distributions.

The second option is to annually divide the year-end balance by the owner's life expectancy, as defined by the Single Life Expectancy Table in IRS Publication 590, Appendix C. Assuming the IRA owner is age 40, he would divide the IRA value by 43.6. If that were $200,000 the first year would be $4,587.16. The next year the new balance would be divided by 42.7. Each year the new balance would be divided by a shorter life expectancy. The remaining account value is accessible, but the annual distributions are inconveniently small at the start and rigidly driven by the Federal life expectancy table.

The third option requires a level distribution through age 59 ½ and a minimum of five years. Once these requirements have been fulfilled, the IRA owner is free to change the rate of withdrawals. The amount of each distribution is determined by the life expectancy table in IRS Publication 590 and the current Applicable Federal Rate – Midterm Table. In this case, applying the same age and principal, in August 2013, the annual distribution would be $6,728.38.

Going back to the $200,000 example, had the IRA owner chosen to use withdrawals from his IRA to fund a life insurance policy, instead of an after-tax value of only $140,000, the widow, initially, could have had the benefit of $395,000 after taxes. At all points up to and including age 70, the net benefit to the family would be greater than the after-tax value of the accumulated IRA by itself. Since IRAs are intended to provide long-term value, and that value can be matched or bettered by the transfer of after-tax distributions into the life insurance policies, there is little or no cost for the added security provided by these policies.

An additional benefit of this plan is the reduction in the Required Minimum Distributions (RMD) at age 70 and beyond. By reducing the RMDs, the IRA owner is less likely to be paying taxes on his Social Security income, because his Adjusted Gross Income would be less. Had he stayed with his original plan, post age 70 Required Minimum Distributions on the larger IRA accumulation would increase the possibility of taxation of his Social Security income.

By adopting the 72(t) solution, the IRA owner also improves access to his savings. By integrating his IRA with the life insurance, he has opened up access to the funds accumulating inside of the life insurance policy. This ties in well with the idea of using the life insurance policy as his personal bank.

By the mid 1990s it became apparent that, for many people, the IRA, with the limitations and penalties that had been built into it, was not the savings tool that it was hyped

to be. In response to this, the Taxpayer Relief Act of 1997, TRA-97, included the creation of the Roth IRA. This has turned retirement savings up-side-down. This is the alternative account referred to on pages 35 and 36. It is my belief that this is much better than the traditional IRA.

Comparing Traditional and Roth IRAs

	Traditional	Roth
1	Contributions tax-deferred	Contributions taxed
2	Maximum annual contribution < age 50: $5,500	Maximum annual contribution < age 50: $5,500
3	Maximum annual contribution > age 50: $6,500	Maximum annual contribution > age 50: $6,500
4	A percentage of the deposit accrues to the Gov.	Entire savings accrues for the depositor
5	Interest accumulates tax-deferred	Interest accumulates tax-deferred
6	Distributions after 59 1/2 are taxable	Distributions after 59 1/2 are tax-free
7	Withdrawals prior to 59 1/2 usually penalized	Withdrawals of cost basis may be penalty-free
8	Required Minimum Distributions after age 70	No required distributions at any age
9	Distributions affect Adjusted Gross Income	Distributions do not affect Adjusted Gross Income

Explanatory Notes

2 & 3. Contributions cannot exceed annual income.

4. Since both have same maximum contribution limits, Roth contributions provide greater net deposits.

7. First home withdrawal, education funding, and IRC 72(t) distributions are taxable, but penalty-free.

8. Distributions from traditional IRAs that are less than required are penalized 1/2 of the difference between the RMD and the amount withdrawn.

9. Distributions affecting the AGI may cause taxation of Social Security income.

It is my understanding that as of 2010, it has become possible under current law for anyone to roll traditional IRA funds into Roth IRAs. This can be done without the Premature Distribution Penalty. And it is worthwhile to do so. However, the income tax generated by this transaction must come from other funds. Using part of the IRA to pay the income tax will result in the Premature Distribution Penalty for those under age 59 ½.

For those who have no need for life insurance, and are interested in only the retirement benefit, if they are depositing within the IRA maximum, the Roth IRA is the logical choice. For the sake of safety, I recommend the use of traditional Fixed Annuities, the newer Fixed Indexed Annuities and/or Certificates of Deposit. Usually the annuities will do better than the bank CDs, but there are occasions that favor banks.

As noted previously, there is no limit as to how many IRAs one may have. Depending on your situation, you may benefit from having all three types. Talk to a professional life insurance agent (preferably a member of the National Association of Insurance and Financial Advisors) about the annuity options and features that may be of value to you.

IRC 72(t) transfers to life insurance, and Roth IRAs, serve as ways to fix the problems of traditional IRA. Indirectly these also play a part in fixing 401(k)s. In the next chapter, problems associated with 401(k)s will be exposed.

Referenced from page 35, end of second paragraph:

The attachment that follows has been excerpted from: Is the Federal Government Eyeing Your 401K? by Cathy DeWitt Dunn, founder of Annuity Watch USA

"The automatic IRA referenced above started with S.3760, the Automatic IRA Act of 2010 which was introduced by Democrat Senators Jeff Bingaman and John Kerry. This bill was referred to committee and subsequently died. However, the legislation resurfaced as S.1557 and was reintroduced in the Senate on September 14, 2011 as the Automatic IRA Act of 2011. It too died in committee, but wait, on February 16, 2012, H.R. 4049, the Automatic IRA Act of 2012 was introduced this time in the House by Rep. Richard Neal and again died in committee. I would say it is safe to assume that the federal government is very interested in the "retirement planning" industry and as you can see, is quite persistent about it."

Jerome Corsi ran an article on November 25, 2012 on WND where he stated:

"Recent evidence suggests government officials continue to eye the multi-trillion dollar private retirement savings market, including IRAs and 401(k) plans, eyeing the opportunity to redistribute private retirement savings to less affluent Americans and to force the retirement savings out of the private market and into government-controlled programs investing in government-issued debt."

"Should you be concerned if you have an IRA and/or a 401(k) plan? Let's ask that question another way; do you think "*investing in government-issued debt*" is a good way to use your IRA and 401(k) savings? I don't think so either. What can you do about it"

Chapter 10
Fixing Qualified Plans – 401(k)s

The traditional IRA has not been the wonderful financial product I thought it was going to be in 1975. But I believe the 401(k) has actually been destructive. So much so, that in this chapter may be the seed of a financial revolution. In answering questions over the last fifteen years on the internet, I have had more questions about 401(k) loans than almost any other topic. Invariably, I have to give the questioner an unsatisfactory response. Often these loans could have been avoided, if the employees had been more careful in what they had been committing to have deducted from their pay each month.

The 401(k), when it is offered without employer matching, is only different from a traditional IRA in the maximum amount that can be contributed. Without the employer match, many employees choose not to participate. It might be because these employees have figured out that there is no significant tax advantage in locking up part of their income this way.

When the employer offers to match all or a portion of the employee's contributions, and the employee does not participate, this is seen as money lost to the employee. Therefore, the employer's offer to match is a form of coercion. To get the maximum employer contribution, many employees are inclined to commit to larger deductions than their families can afford. This can lead to increasing debt. Without thinking about it, the employees' indebtedness interest could build up to be greater than the employer's matching contributions. Eventually, the debts become too great to handle.

At that point an employee is likely to turn to his 401(k) for a hardship loan to restructure his debts. The Federal Government allows five years to pay off this loan. However, payments must begin immediately. Periodic repayments must be no less frequently than quarterly. What may happen is the employer will set up an automatic withholding from the employee's pay.

Whether by pay reduction or quarterly payments, the net result is less spendable income for that employee's household. This is often the cause of stress within the family that translates into on-the-job dissatisfaction. According to a Reuter's report in June 2009, 63% of Human Resource and Senior Finance Executives polled reported that employee concerns over personal finances resulted in a more difficult work environment.

Once a worker's morale becomes impacted, either the employee or his employer might be led to believe that the employee should be elsewhere. If the employee is fired or voluntarily leaves, the loan must be paid back. If not, the outstanding balance is taxable, and if the employee is not yet retirement age, he would be subject to the Premature Distribution Penalty.

Since the presence of the outstanding 401(k) loan is an indication that he has no other savings, if he is terminated toward the end of the year, he faces the immediate obligation of a large tax bill and penalty with no means to pay it, except from what remains of his 401(k). Of course that leads to more tax and more penalty.

This is compounded by the fact that money transferred from the account to the employee will have 20% withheld and sent directly to the IRS. If this is not restored, it will be taxed and, if under the age of 59 ½, the participant will be subjected to the Premature Distribution Penalty for that 20% withheld.

Seeing that postponing the taxation frequently results in higher taxes, and therefore is not really benefiting the employees, is it doing anything worthwhile for the employer? It has been suggested that it does help in recruitment and retention of good employees. If that is its only redeeming value to the employer, there is what I believe to be a better way to accomplish the same thing.

How can it make sense for an employer to tie company contributions to payroll? Employer contributions should be determined by company profitability. If profits are insufficient to cover the employer's 401(k) participation, the company's longevity is threatened. I have seen required retirement funding by a company result in the demise of the company and the loss of employees' jobs.

The company does have the option of eliminating the employer contributions, just as has been done by companies like General Motors. It has been reported that as many as 25% of companies in 2009 were contemplating dropping the employer match. This cannot help but lower employee satisfaction, since what has been given becomes in the mind of recipients an entitlement.

The reasonable alternative to 401(k)s is for the employer to disconnect voluntary employee participation in salary deduction plans from employer contributions. If the employer wants to contribute toward employee retirement accounts, it should be a pure Profit Sharing Plan. Such plans provide greater company stability, since contributions are based on profitability, not payroll.

A secondary, but important, benefit of pure Profit Sharing Plans is the implied employee share in the success of the company. Bigger profits generate bigger contributions to the employees. This could result in larger employer contributions than the 401(k)s, while protecting the company from losses when profits are small. This sense of ownership can create a more productive work environment. This then, in my opinion, should benefit all engaged in the operation of the company, whether hourly employees, officers or stockholders. As the saying goes, "A rising tide raises all boats."

Employees' contributions could be directed toward traditional IRAs (not the best option), Roth IRAs, life insurance, non-qualified savings, or Roth 401(k) s. These choices then become the responsibility of the employees. The employer would no longer be the target for criticism due to unsatisfactory performance of the employees' retirement accounts.

Recognizing that change is often slow and difficult, and that in spite of the negatives about 401(k)s, they will remain popular for quite some time, I offer these points to remember:

1. If the employer does not match, there is no reason to tie up your funds in a 401(k).

2. If the employer does match, it is prudent to limit your contribution to the amount that your employer will match, but only as much as what will not hurt your family budget.

3. If you leave the company, directly transfer your 401(k) into a 'pour-over' IRA, to avoid the 20% withholding and the accidental loss of the account.

4. Do not transfer a previous 401(k) account over to a new employer's administrator. A change of employment is a perfect time to move one's 401(k) into a traditional IRA, where it could then fund life insurance, as described in Chapter 9 or be transformed into a Roth IRA. As long as your funds remain in the 401(k), access is unnecessarily limited.

Hardship loans paid back in an orderly fashion usually avoid a Premature Distribution Penalty. However, several years ago, I have learned that paying off such a loan too quickly will generate the penalty. In this case it was a businessman who had started a new venture. Having run out of cash, he borrowed on his 401(k) to get the new enterprise going. Once he resolved his cash problem, he paid off the loan. The loan, because it was short term, was re-defined as not a hardship loan. Thus, he was penalized for a premature distribution, even though he had paid back the funds.

This re-enforces the value of rolling the funds into a traditional IRA, and by way of a

72(t) transfer program, into life insurance for loan purposes. But, unless you are changing jobs, how can you move 401(k) funds into the IRA in the first place?

This concept I learned from Dr. Sheldon Smith, and confirmed it by talking to an IRS representative. 401(k) plans require a Summary Plan Document (SPD). In filling out the SPD form there is the option of permitting Non-hardship Transfers to Self-directed IRAs. For employees under the age of 59 ½, employer contributions and 401(k) funds rolled over from a previous employer, held in a separate account, qualify for these transfers. Those employees who are older than 59 ½ can be allowed to transfer all their 401(k) funds, even while the employees remain with their current company and continue to participate in their companies' 401(k) plans.

For those employees that work for companies that have not yet made this option available, I suggest that the issue be raised. I expect that there would be opposition by the 401(k) administrators, since they are compensated in relationship to the amount they have under management. But greater freedom is better for the employees, and is sure to enhance the morale of the companies' workforce.

In summary, allowing employees participating in 401(k)s to do Non-hardship Transfers to Self-directed IRAs enable the employees to reduce investment risks and improve access to funds as needed. However, a pure Profit Sharing Plan with voluntary employee contributions to plans of their own choosing grants employees greater control and provides the same recruitment and retention value as 401(k)s, and protects the companies from unnecessary financial drain. Giving the employees more control over their retirement accounts facilitates better working conditions and better job security.

Annuities

Life insurance is a contract composed of the practical theories of life expectancy and investment earnings. The more obvious function is the goal of producing cash when needed, when an insured does not live long enough to complete his financial responsibility. For this purpose, company actuaries (number crunchers) determine how much money needs to be collected, at what earnings rate, along with what charges to build into the premiums to cover the risk of clients living too short.

The flip-side of this contract form is calculating how much needs to be accumulated to provide an income for a set period of time or for living too long. This alternate financial vehicle is called an Annuity. Annuities are contracts that guarantee income. The contracts can be funded by life insurance Death Benefits, or if the life insurance is no longer needed for the creation of money at death, the policy's Cash Surrender Value. Other investments or a pattern of premiums like those paid into life insurance can be used to fund annuities.

Federal rules applicable to annuities are similar to those of Qualified plans. All earnings grow tax-deferred until withdrawn. With the exception of Roth IRAs, all distributions are first earnings, and subject to a premature distribution penalty, if taken prior to age 59 ½.

There are several types of annuities. The first subdivision is Immediate and Deferred Annuities. Immediate Annuities are an exchange of a guarantee of periodic income in place of a deposit of a specified amount. This amount becomes the property of the insurance company. It is no longer an asset of the client for whom the contract of income has been created.

Two types of Immediate Annuities are offered. Fixed Immediate Annuities provide a guaranteed periodic income for as long as the contract specifies, whether lifetime or for a specific period of time. These are preferred by those who want certainty of income for as long as the contract term. The second, Variable Immediate Annuities provide periodic income affected by the upward or downward movement of the stock market.

VIAs are attractive to those who believe that the stock market will grow at a faster rate than what can be projected by other more conservative vehicles. A purchase of a VIA is represented as having contracted for a specific number of units of periodic income. The dollar value of these units increase or decrease for each periodic payment, based on the performance of the funds in which the original investment was made. The specific amount of each periodic payment is not guaranteed.

Deferred Annuities are subdivided into three types. Alphabetically, these are Fixed Annuities (FAs), Fixed Indexed Annuities (FIAs), and Variable Annuities (VAs). Fixed Annuity earnings are not related to stock market performance in any way. Interest is paid into these annuities based on the interest the insurance companies were able to earn, after expenses and reasonable profit, on loans and bonds held by these companies.

Interest paid into these annuities may have a current interest guaranteed for a period of time, followed by a lower long term rate, typically 1%. When possible these annuities can earn rates of return that exceed the rates projected or guaranteed at the time of the transaction. While the most conservative of annuity types, over the last decade or so, these have been the best value.

Fixed Indexed Annuities, originally called Equity Indexed Annuities, are designed to give the client a portion of the gain in the stock market, without any of the downward movement of the stock market. These annuities are pegged to such creations as the S&P500, NASDAQ, and the Dow Jones Industrial Average.

There are many ways to value the gains in the FIAs. All of these constructs are based on models that, in theory, have the possibility of greater long term growth than the FAs without the risk of loss due to stock market drops. Whatever model chosen is designed to participate in stock market index gains over specified periods of one to ten years, without sharing in stock market losses. The two most understood models are gains based on movement from point-to-point, from anniversary to anniversary; and the average monthly index over the anniversary baseline. A third model adds up the gains and losses of point-to-point monthly indexes.

All of these models are subject to Caps, Spreads, and Participation Percentage Limits. A Cap might be all the gain up to a maximum per term of 6%. A Spread might allow for 100% of the gain minus 2%. A Participation Percentage Limit might offer 50% of all term gain without a Cap.

An example of an annual point-to-point annual gain, in which the index had gone from 1000 to 1200, if the Cap was 6%, and the participation rate was 100%, and there was no Spread: The index gain would be 20%, but with a Cap of 6%, the interest paid would be 6%. Had the Participation rate been 50%, with no Cap, the annuity would have earned 10%.

Suppose the model chosen had been S&P 500 Index starting at 1000 and increasing nine points each month, reaching 1108 on the contract anniversary. Over that year the Index would have gained 10.8% in value. This would have been the gain experienced in a mutual fund based on this model, before deductions for fund charges. If this had been a monthly

average FIA, these monthly points would have been added together and divided by twelve, resulting in a gain in the FIA of 5.85%.

Had the FIA been monthly point-to-point, and there had been a 2% monthly cap, and the Index had performed as in the previous example, the gain would have been the full 10.8%. However, suppose several of the months the index had gone down, even with the over-all index gain was 20%, there might have been no gain in the annuity.

Compounding all of the variables is the fact that the issuing insurance company can change the Caps, Participation Percentages and spreads at the end of each term cycle. This is disclosed in the company advertising pieces, but it is not illustrated. Therefore, projections at the time of the acquisition of these annuities are not assurances that they will perform as shown.

Because the actual performance of the FIAs is unpredictable, and therefore possibly less advantageous than the older Fixed Annuity, many of the companies offer a rider that creates an artificial value designed to offer a higher income stream when the policy is turned into periodic income. This contract benefit, which is also available with Variable Deferred Annuities, provides some security for income planning. However, this does not equate to contracted surrender value. Even if the Income Account Value may have averaged 5-7% compounded over 10-20 years, the surrender value could be much less.

Variable Annuities are securities (requiring FINRA disclosure pamphlets) within the tax-advantaged structure like the Fixed Annuity. As with the FA and FIA, all gains are sheltered from current income reporting. This characteristic is desirable for those who have sufficient other income and are seeking to avoid taxation of their Social Security income. On the other hand, unlike the FA and FIA, there is no protection of the account value from stock market losses.

Acquiring annuities have costs. Either the marketer of the annuities will charge a fee for his service, or the insurance company will impose a surrender charge for early termination. Therefore, annuities are not meant for investing in for short periods of time. If you need some near term liquidity, short term Certificates of Deposit and passbook or checking account savings still have merit.

Having several contracts taken out more than a year apart, or with different companies allows the annuity owner to defer taxation on some annuities while taking distributions on others. This strategy often is used to reduce the amount of taxes charged against Social Security income. This is another advantage had by life insurance and annuities over interest generated in double-tax-free bonds. Interest on these bonds are reportable, thus

increasing one's Adjustable Gross Income, and thus, forcing the taxation of Social Security.

In review: All annuities are contracts meant to provide periodic income at some time in the future. Until that time, all gains not withdrawn accumulate unreported and untaxed. As a trade-off, unless certain rules are applied, distributions prior to 59 ½ are subject to Premature Distribution Penalties.

Fixed Annuities and Fixed Indexed Annuities are insurance products, and therefore protected from stock market losses. Variable Annuities, though offered by insurance companies , because of their inherent risk, are deemed a security product.

A way to overcome the low interest generated by bank savings is to take a portion of bank savings and establish immediate Annuity income backed by a single premium life insurance policy to restore a legacy for one's heirs.

As of this date, September 8, 2015, interest rates are at historic lows. Thus, combined with the fact that except for deferred annuities in Roth IRAs, someone at some point will have to pay income taxes on the gains, it is the conclusion of this writer that deferred annuities be used primarily as means to redirect IRAs and 401(k) accounts into 72(t) redistribution programs into appropriate forms of life insurance. Competitive Whole Life or Universal Life policies are providing better long-term projections with the added benefit income tax-free distributions to beneficiaries at the death of the insured.

Chapter 12
Policy Ownership-
Closer to Rocket Science than the Buying of Apples

It seems that most people may be making a mistake when they buy life insurance, because they do not understand all that it means to be a life insurance policy owner. So, what does it mean to own a life insurance policy?

If you have title to your car, you own that car. The title cannot be transferred or sold without your consent. As owner, you have full responsibility for that car. Likewise, if you have title to your home, you own your home. Your home cannot be sold without your consent. Your home cannot be used as collateral without your consent. As owner, you control what happens to your home. If you own a life insurance policy, you control it. It is an asset just like your car and home. You, as owner, have the legal and contractual right to make changes to the policy, to use it as collateral for a loan, and to sell or give it away. All rights vest in you as long as you are the owner.

Can the owner and insured be the same party? Can they be different parties?

Generally, policies for the benefit of one's family have been owned by the insured. On the other hand, when a policy is taken out by an employer for the benefit of the employer (usually referred to as 'key person insurance'), the employer is the owner and the beneficiary. Could it be that most insurance agents have been wrong in usually having the insured as the owner of the policy?

The owner of the policy should be determined by the purposes of the policy and the competency of the beneficiary(ies), and the relationship to the insured. The best way I know of explaining this is by using examples. Let's take a look at some situations, and briefly discuss why we would choose one arrangement over the other.

Scenario #1

Single young adult knowledgeable about the saving-to-spend function of Whole Life insurance: This insured should be the owner. Author's presumption is that a young single can change the ownership of the policy to the future spouse at the same time as designating the spouse as beneficiary.

Scenario #2

Married couple, with both in agreement on how to use the policy: The beneficiary should be the owner. There are a couple of considerations here. Number one is the fact that the non-owner insured is most likely to be in agreement with any action that the owner-beneficiary wishes to take. On the other hand, in the event of a divorce, if the life insurance policy is owned by the beneficiary, it would be protected from inappropriate termination by the insured.

Scenario #3

Married couple with some differences of opinion as to financial perspectives: The insured is the logical choice, since in this case there may be concern by the insured that the intended beneficiary might abuse or terminate the policy. It might be the insured's opinion that the beneficiary should receive a monthly income, rather than the entire death benefit all at once.

Scenario #4

Executive or investor with assets near to or in excess of $1,000,000: In this case the owner is likely to be an Irrevocable Life Insurance Trust (ILIT). When a person dies leaving an estate greater than the established Excludable Amount to a non-spousal relative, the excess will be subject to the Federal Estate Tax. A life insurance policy owned by the insured in this example could lose approximately half of its value to the IRS, since ownership by the insured makes the policy part of the deceased's estate. The reason the author has a $1,000,000 threshold is the lack of certainty over what Congress plans to do.

An Irrevocable Life Insurance Trust is a legal entity that is the owner and primary beneficiary of the life insurance policy. By having the policy owned and paid for by the ILIT, the insured has no ownership control of the policy. Therefore, the policy is not part of the deceased's estate.

With the ILIT as the primary beneficiary, the intended recipients of the proceeds would be the beneficiaries of the ILIT. The premiums paid by the ILIT typically are funded by gifts from the insured and the insured's spouse that are paid into the trust. So long as these gifts do not exceed the annual per person maximum allowed by Federal law (per the beneficiaries of the ILIT), these would not be subject to a gift tax, and neither the premiums paid from the monetary gifts nor the life insurance death benefit would be charged the Federal Estate Tax.

For 2014, benefactors can give up to $14,000 per year to as many recipients as they want without incurring a Federal Gift Tax. Amounts in excess of the annual maximum can be taken from the maximum Estate Tax exclusion. When funding an ILIT, a married couple can each grant the annual maximum times the number of heirs to the trust.

Scenario #5

Parents with minor children as contingent beneficiaries: Spouses as owner-beneficiaries with a Living Trust for the benefit of the children. In the state of this author's residency children under the age of 18 are not entitled to receive the proceeds from a life insurance policy. In order for those under age 18 to benefit from policies on the parents, it is necessary to have a trustee to administer the funds created by the death of the parent(s). The Living Trust is created to receive the proceeds from a life insurance policy. A trustee is appointed in the trust for the purpose of following written instructions in the trust for the benefit of the minor beneficiaries. This trust is called a Living Trust, but it does not go into effect until it is funded at a parent's death. Unlike the Irrevocable Life Insurance Trust, during the lifetime of the creator of the trust, its instructions can be changed.

Scenario #6

Older single adult: Adult offspring as owner and beneficiary. In the event that an insured needs assistance to cover the cost of long-term care, life insurance owned by a senior is vulnerable to Medicaid rules. If the policy is owned by the beneficiary, the policy usually is out of reach of Medicaid. This would not be true in cases where ownership had been transferred from the insured to the beneficiary within the resident-state's definition of the 'look-back period.'

These are some of the issues that impact the decision as to who should be the owner. Applying the examples above to other situations may help clarify who the owner should be. Individual considerations might alter the judgment of the client and agent. But simply having become familiar with these options should make the process easier.

The references to trusts mentioned in this chapter are not meant to imply that the author is providing legal advice. They are presented as issues which the reader may want to discuss with an estate planning attorney.

‘

Appendix

Monthly Income

Primary Income	
Secondary Income	
Commissions	
Interest	
Dividends	
Rental Income	
Royalties	
Social Security	
Pension Benefits	
Annuities	
Total Income	

Outstanding Debts

First mortgage	
Second mortgage	
Card	
Card	
Card	
Auto	
Auto	
Personal	

Debt Recap

Long Term Debt	
Short Term Debt	

Assets

Home Equity	
Income Property	
Investments	
Bank Accounts	
Retirement Funds	
Life Insurance	
Life Insurance	
Disability Income	
Disability Income	

Outlay

Tithes & Offerings	
Housing (rent, mortgage)	
Telephone	
Electric & Gas	
Water and trash	
Internet	
Food	
Clothing	
Debt Payments	
Entertainment	
Car Payments	
Gas & Oil	
Car Maintenance	
Medical/ Dental Care	
Auto Insurance	
Home Insurance	
Health Insurance	
Disability Insurance	
Life Insurance	
Income Taxes	
Property Taxes	
Business (Schedule C)	
Retirement Savings	
Retirement Savings	

Investing

Emergency Savings	
College Savings	
Miscellaneous	
Total Outlay	

Cash Flow Recap

Income	
Outlay	
Difference	

Creating a Budget Worksheet

(Chapter 4, per page 9)

On page 9 of this manual you have an example of the above budget worksheet. You can copy the example on Appendix page 1, or create your own template with the cell entries below. Once you have the data cells laid out, you may want to enhance the worksheet by adding cell base borders and title borders.

Set column widths: A: 24.14, B: 15.43, C: 7.57, D: 24.14, E: 15.43

Cell entries:

Row 1, Columns A-E: '**Monthly Budget/Asset Management**'

Row 4, Column A: 'Name', D-E: 'Expenses'

Row 5, Column A: 'Phone'

Row 6, Column A: 'E-mail', D: 'Tithes & Offerings'

Row 7, Column A: 'Address', D: 'Housing (rent, mortgage)'

Row 8, Column A: 'Dates of Birth', D: 'Telephone'

Row 9, Column D: 'Electric & Gas'

Row 10, Columns A-B: 'Income', D: 'Water & Trash'

Row 11, Column D: 'Internet'

Row 12, Column A: 'Primary Income', D: 'Food'

Row 13, Column A: 'Secondary Income', D: 'Clothing

Row 14, Column A: 'Commissions', D: 'Debt Payments'

Row 15, Column A: 'Interest', D: 'Entertainment'

Row 16, Column A: 'Dividends', D: 'Car Payments'

Row 17, Column A: 'Rental Income', D: 'Gas & Oil'

Row 18, Column A: 'Royalties', D: 'Car Maintenance

Row 19, Column A: 'Social Security', D: 'Medical/Dental Care'

Row 20, Column A: 'Pension Benefits', D: 'Auto Insurance'

Row 21, Column A: 'Annuities', D: 'Home Insurance'

Row 22, Column D: ‘Health Insurance,

Row23, Column A: ‘Total Income’, B: =sum(B12:B21), D: ‘Disability Insurance’

Row 24, Column D: ‘Life Insurance’

Row 25, Columns A-B: ‘Outstanding Debts’, D: ‘Income Taxes’

Row 26, Column D: ‘Property Taxes”

Row 27, Column A: ‘First Mortgage’, D: ‘Business (Schedule C)’

Row 28, Column A: Second Mortgage’, D: ‘Retirement Savings’

Row 29 Column A: ‘Card’, D: ‘Retirement Savings”

Row 30, Column A:‘Card’, D: ‘Investing’

Row 31, Column A: ‘Card’, D: ‘Emergency Savings”

Row 32, Column A: ‘Auto’, D: ‘College Savings’

Row 33, Column A: ‘Auto’, D: ‘Miscellaneous’

Row 34, Column A: ‘Personal Loan’

Row 35 Column E: =sum(E6:E33)

Row 36, Columns A-B: ‘Assets’

Row 37, Columns D-E: ‘Cash Flow Recap’

Row 38, Column A: ‘Home Equity’

Row 39, Column A: ‘Income Property’, D: ‘Income’, E: =B23

Row 40, Column A: ‘Investments”, D: ‘Expenses’, E: =E35

Row 41, Column A: ‘Bank Accounts’, D: ‘Difference’, E: =E39-E40

Row 42, Column A: ‘Annuities’

Row 43, Column A: ‘Life Insurance’, D-E: ‘Debt Recap’

Row 44, Column A: ‘Life Insurance’

Row 45, Column A: ‘Disability Income”, D: ‘Long Term Debt’, E: =B27+B28

Row 46, Column A: ‘Disability Income”, D: ‘Short Term Debt’, E: =sum(B29:B34)

Abbreviated Inflation and Tax Bracket History – 58 Years

	Inflation	Minimum Tax Bracket	Maximum Tax Bracket
2012	2.10%	10%	35%
2009	-.35%	10%	35%
2006	3.23%	10%	35%
2003	2.28%	10%	35%
2000	3.36%	15%	39.6%
1997	2.29%	15%	39.6%
1994	2.56%	15%	39.6%
1991	4.21%	15%	31%
1988	4.14%	15%	28%
1985	3.56%	0%	50%
1982	6.16%	0%	50%
1979	11.35%	0%	70%
1976	5.76%	14%	70%
1973	6.22%	14%	70%
1970	5.72%	14%	70%
1967	3.09%	14%	70%
1964	1.31%	16%	77%
1961	1.01%	20%	91%
1958	2.85 %	20%	91%
1955	-.37%	20%	91%

As illustrated above, we cannot accurately predict future tax rates or inflation. Therefore, it is imperative to carefully save to assure adequate income for the rest of our lives, and do as much as possible to enhance that portion of our retirement income, which can be received as unreportable. Just because you might be in he highest tax bracket today at 39.6%, that does not mean that you would be in a lower tax bracket at retirement.

The 72(t) Solution

In this illustration we see that Fred assumes that he had intended to continue annual contributions of $5,000 pre-tax into his IRA each year till age 70. Because of his new awareness, he chooses to pay the taxes on that $5,000 and fund his life insurance with the remainder along with the yearly after-tax distribution from his current IRA. It is not important what the IRA is in, whether it be a bank plan, mutual fund, or an annuity.

In order to know what he can withdraw each year he needs to find the current mid-term Applicable Federal Rate, at http://www.timevalue.com, and his current life expectancy as stated in IRC Publication 590, Table I, pages 88-89, also found on page 7 of the Appendix.

Part 1

Illustrated for:		Fred Parker	
IRA Owner:	Fred	40	
Life Expectancy:		43.6	Years
Insured:	Fred	40	
Tax Bracket:		30.00%	
IRA Accumulation Rate:		2.00%	CD IRA, January, 2014
Applicable Federal Rate:		1.75%	(AFR Mid-Term, January, 2014)
IRA Balance:		$80,000	After Tax Value : $59,500.00
Annual Deposits:		$5,000	
Interest Factor:*	1.2	2.10%	120% of AFR
Annual Distribution:		$7,761.23	
Projected Income Tax:		$2,328.37	
Available for Life Insurance:		$5,432.86	

Continued on next page.

Part 2

Initial Face Amount:	$353,106.00		
Plus IRA Balance of:	$77,238.77	After Tax Value :	$54,067.14
Enhanced Legacy	$430,344.77	After Tax Value :	$407,173.14

Values at Insured's Age 65

	Gross Estate Value	Gross Surrender Value	Retaining IRA
Life Insurance:	$500,635.00	$216,929.00	-
Projected IRA Value:	$41,036.59	$41,036.59	$294,603.01
Income Tax:	$12,310.98	$36,643.23	$88,380.90
Net After-Tax Benefit:	$529,360.61	$221,322.37	$206,222.11
Equivalent Yield:	6.89%	2.38%	2.00%

Values at Insured's Age 70

	Gross Estate Value	Gross Surrender Value	Retaining IRA
Life Insurance:	$557,120.00	$296,119.00	-
Projected IRA Value:	$30,650.77	$30,650.77	$351,806.13
Income Tax:	$9,195.23	$49,135.19	$105,541.84
Net After-Tax Benefit:	$578,575.54	$277,634.58	$246,264.29
Equivalent Yield:	5.74%	2.54%	2.00%

IRA Values at IRA Owner's Age 70

Projected IRA Value:	$30,650.77	$30,650.77	$351,806.13
Req'd Distributions @ 70:	$1,118.64	$1,118.64	$12,839.64

Actual results may be higher or lower than shown. This illustration is based on figures available on January, 18, 2014.

Publication 590 - Table I Single Life Expectancy

Age	15	16	17	18	19	20	21	22	23	24	25	26
Exp.	67.9	66.9	66.0	65.0	64.0	63.0	62.1	61.1	60.1	59.1	58.2	57.2
Age	27	28	29	30	31	32	33	34	35	36	37	38
Exp.	56.2	55.3	54.3	53.3	52.4	51.4	50.4	49.4	48.5	47.5	46.5	45.6
Age	39	40	41	42	43	44	45	46	47	48	49	50
Exp.	44.6	43.6	42.7	41.7	40.7	39.8	38.8	37.9	37.0	36.0	.35.1	34.2
Age	51	52	53	54	55	56	57	58	59	60	61	62
Exp.	33.3	32.3	31.4	30.5	29.6	28.7	27.9	27.0	26.1	25.2	24.4	23.5
Age	63	64	65	66	67	68	69					
Exp.	22.7	21.8	21.0	20.2	19.4	18.6	17.8					

Publication 590 - Table III Uniform Lifetime Expectancy

(Required Minimum Distribution Divisors)

Age	70	71	72	73	74	75	76	77	78	79	80	81
RMD	27.4	26.5	25.6	24.7	23.8	22.9	22.0	21.2	20.3	19.5	18.7	17.9
Age	82	83	84	85	86	87	88	89	90	91	92	93
RMD	17.1	16.3	15.5	14.8	14.1	13.4	12.7	12.0	11.4	10.8	10.2	9.6
Age	94	95	96	97	98	99	100	101	102	103	104	105
RMD	9.1	8.6	8.1	7.6	7.1	6.7	6.3	5.9	5.5	5.2	4.9	4.5