

# **New Uses for Life Insurance**

Find out some of the ways producers are using this venerable tool to help solve a wide range of financial problems.

**By Dave Willis**

In the 1970s, the orange juice industry taught us that a day without orange juice was like a day without sunshine. We got the message and made OJ a vital part of our morning regimen. But the message may have pigeonholed the citrusy drink, because a decade or two later, growers came out with a different message: “Orange juice. It’s not just for breakfast anymore.”

It’s hard to miss the similarity to life insurance. The industry has succeeded in convincing consumers that life insurance is not just about death benefits anymore; it is also the foundation of a sound financial plan, with myriad and diverse uses.

## **Life insurance as a lifelong tool**

Thanks to technology, life insurance is now a universal, lifelong financial tool that should be part of anybody’s arsenal, according to David Vanderzee CLU, ChFC, LUTCF, owner of Vanderzee Financial & Insurance Agency in Clifton Park, N.Y., and a member of Capital District AIFA. “It’s one of the few products left that has a start and a finish,” he says. “And it will serve just about any individual as a good investment tool. If you put money into it on the permanent side and don’t make it, it matures. If you do make it, you can annuitize or take a paid-up policy,” he says.

That’s not entirely new thinking, of course. But what is new is the flexibility that allows it to be a lifelong tool, thanks in large part to technology. “Because of computers, policies have gotten more bells and whistles,” he says. “You don’t have to buy a new policy every time you want to change something.”

Before, advisors encouraged people to put a little extra money aside every month so that when their insurance needs grew, they could buy a new policy. That’s no longer necessary. Vanderzee says, “You have the flexibility of raising and lowering the amount you pay, and raising and lowering the death benefit to meet your needs.” For example, a business owner might land a big project and need to add an extra million dollars of coverage for a couple of years, he explains. Then he may or may not drop that. Then all of a sudden, he may need to increase it or lower it again.

## **Supporting business continuity**

Life insurance can be used in other creative ways to support business needs. Tax law changes in the last part of the 1990s, for instance, paved the way for the growth of one such use—ESOP repurchase liability funding. An employee stock ownership plan is a benefit plan that buys and holds a company’s stock. It is often used as a way to transfer ownership from an individual or individuals to the company’s employees. While ESOPs have been around for some time, their number has grown dramatically since 1997

changes to the tax laws allowed S corporations to form ESOPs. Establishing and managing ESOPs is not for the fainthearted, however. One of the many issues to address is how employees or their heirs are compensated for their share in the company in case of retirement, disability or death. According to Wayne Minich, CLU, ChFC, president of Applied Financial Concepts in Richfield, Ohio, life insurance is becoming an increasingly popular way to do that. “The company must buy back ‘Joe’s’ beneficial interest in XYZ Corporation when he’s getting ready to retire,” Minich says. “Actually, there’s a need for money before that because, at age 55, Joe can request that 25 percent of his ESOP money be allocated to other investments—something that has occurred largely because of the Enron problem.” More diversification can be requested at age 60.

The problem is that quite often, as the value of the company increases over time, so does the value of each participant’s shares. Of course, for Joe, this appreciation is a good thing. But for the company, it could put the repurchase liability out of reach, at least if it is using available cash flow. That’s where the insurance comes in. “What we very often do is insure the top five or six people—that high-income group, those we’re going to have a problem buying out,” Minich says. “We use a COLI type of product, with a high early cash value. So from a balance-sheet standpoint, at the end of year one, they usually have a cash value close to, equal to or perhaps in excess of the first year’s premium.”

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maintain. In most cases, advisors would do well to partner with other professionals when working with them.

Remember that there are three ways to cash out of an ESOP: retirement, death or disability. In case of death, the life insurance would fund the repurchase. In case of retirement or disability, the cash value could be tapped. While it sounds somewhat simple, Minich warns that ESOPs are actually quite complicated and require some detailed steps to set up and

## **Easing the pain of premiums**

David Gibson, CFP, agency manager for Country Insurance and Financial Services in Morris, Ill., suggests another use for life insurance—a somewhat unconventional but very practical and attractive new use. He advocates using life insurance, or a combination of life insurance and a Roth IRA, to fund what he calls a total account refund. This is a way to give a client back all of the premiums he has paid for other kinds of insurance. This idea sounds grand, but according to Gibson, it’s quite simple.

Here’s the premise: Over the course of a lifetime, people pay a lot of money for auto and homeowners insurance. But the only way they ever get any of that back is when they file a claim. And that’s not something most of them look forward to doing. That’s where Gibson’s idea comes in. “Total account refund is a way to use some money to fund a life contract, to recapture the equivalent of those premium dollars that have gone out the door over the course of a lifetime,” he says. So you pull out your calculator and crunch some numbers.

Assume the clients will pay a thousand dollars a year for homeowners insurance and a couple thousand for auto, and they’ll do that for 40 years. “Show them, with discounted dollars, how they can recapture that money, using cash-value life insurance to either save to get that \$120,000 back or, when they pass away, to provide that money back to their

heirs,” Gibson says. “If they are paying \$3,000 a year on insurance costs, suggest instead that they put in \$4,000 or \$5,000 each year, then take that extra money to fund the life insurance policy and, if applicable, the IRA. When they turn 65 or pass away, all the money is returned to them or to their estate.” Gibson says the idea is particularly attractive to younger families.

## **Life with a little extra**

Life insurance can be used to address other situations, too. For Bruce Dickes, CLU, ChFC, FLMI/M, CSA, marketing vice president for Standard Life and Accident Insurance Co., in League City, Texas, it’s confinement care. Consider Aunt Edna, an imaginary soul that Dickes describes at seminars and other meetings. “Aunt Edna has enough income—maybe just enough—to live on today, but she’s not rich,” he says. “She can pay the rent, keep the lights on and buy food. And she’s got a little nest egg she’d like to leave for the church or her nieces and nephews.” But she doesn’t want to tie her nest egg up for fear of an emergency. And she doesn’t want to be a burden to her family. In short, she wants some choice, flexibility and control.

Aunt Edna wants to leave a legacy. But she worries about what would happen if she needed long-term care. She’s not covered for that and can’t afford to be. She fears that her nest egg—\$40,000 or \$50,000 in a CD, earning no interest to speak of—would get eaten up quickly. If she doesn’t need the care and doesn’t use the savings elsewhere, the church or family would get some of the money, but only some, and only after probate takes a few whacks at it and it gets taxed.

### **LIFE INSURANCE CAN BE USED IN OTHER CREATIVE WAYS TO SUPPORT BUSINESS NEEDS.**

According to Dickes, a smart advisor using the right product can do a lot for Aunt Edna. “Say she has \$50,000, and she’s 65 years old,” he says. “She can buy a single-premium life insurance policy that could provide a lot more money when she dies. At 65, it could be \$110,000 with a \$50,000 deposit.” The church or the kids don’t get \$50,000 and they don’t get it nine months from now. They get \$110,000 and they get it next week. “They avoid taxation, they avoid shrinkage and they avoid probate,” Dickes adds

That’s not all. “Some of these plans have built-in confinement and terminal-illness benefits,” Dickes explains. Some accelerate the full death benefit if something happens, and she needs to go into a nursing home, he adds. “There are plans that have a money-back guarantee from day one,” he says. “So a guarantee of a surrender value of no less than the dollars she put into it, right from the get-go, is a pretty good deal.”

Dickes says his firm even offers a product that accelerates 100 percent of the death benefit for confinement issues, and creates an additional 5 percent when the insured dies. That’s not all. “Some of these plans have built-in confinement and terminal-illness benefits,” Dickes explains. Some accelerate the full death benefit if something happens, and she needs to go into a nursing home, he adds. “There are plans that have a money-back guarantee from day one,” he says. “So a guarantee of a surrender value of no less than the dollars she put into it, right from the get-go, is a pretty good deal.”

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## **A rosy retirement**

Marvin Feldman, CLU, ChFC, RFC, head of Clearwater, Florida-based Feldman Financial Group, and a Pinellas AIFA member, uses life insurance to help high-income earners—generally younger clients—who are preparing for retirement but who may not be able to fully capitalize on other plans, such as 401(k) plans. Feldman, past president of the Million Dollar Round Table, says it's not an entirely new idea but it's used so infrequently that it's new to many advisors.

The idea involves using a fixed-premium or variable-premium product, targeting a specific amount the client wants to contribute. "The client is maxed out on his pension program," Feldman says. "In most situations, he can't put in the maximum because there aren't enough people participating. So instead of contributing \$10,000-plus, he's putting in \$5,000 or \$6,000. So you ask, 'How much would you contribute if you had no limits?'" They might say an additional \$10,000 or \$20,000 a year.

## **Life insurance to the rescue**

Feldman shows how to achieve that goal, tying in life insurance. "He can put in as much as he'd like," Feldman explains. "The money accumulates tax-deferred. And when he retires, he can take it out tax-free, depending on tax laws at the time. Under current tax laws, it's permissible." Specifically, Feldman says, the client converts the lump sum in the policy into an income stream, where he withdraws to basis, then borrows once he's hit the basis. "That generates a tax-free income stream," he adds.

In many circumstances, the plan can be as attractive as noninsurance options. In addition, he says, there are side benefits. "You have an income-tax-free death benefit, which you don't have with a side fund," he says. "Also, you're free from the claims of creditors, depending on your particular state." That's especially attractive for professionals working in industries prone to litigation.

Feldman says the idea could be used much more than it is. In fact, he recently used it on a case he was brought into by another advisor. "The individual was investing primarily in municipal bonds," he says. The client, in his late 40s and single, just inherited a lot of money from his father. And he's extremely concerned about protecting those assets against the claims of creditors. "I presented him with a program in which he would put in \$25,000 a year up to age 70 and then start pulling money out at 70," Feldman says. "When he crunched the numbers, and he did these on his own—he's a computer guy—he said it's comparable to what he'd get if he put money into municipals."

The prospect wasn't keen on insurance. Being single, he saw no need for it. So he challenged Feldman. He asked him, "What's the advantage of the insurance program? I'm coming up with the same rate of return." Feldman told him: "The advantage is that if you get sued, all the money you're investing in your municipal bond portfolio would be subject to claims of that creditor. Money you put into the life insurance product won't be, given the state you're currently residing in."

## **Whole life doing a whole lot**

Life insurance can serve as more than a source of funds for retirees. According to Jon

Ballou, CLU, vice president of advanced sales for MTL Insurance Co. in Oak Brook, Ill., it can work well as an annuity alternative, too. If sales numbers mean anything, others agree. A single-premium whole life product as an annuity alternative is, according to Ballou, “our biggest seller in the last year or so.”

Much of the recent interest in the product comes in the throes of regulatory scrutiny of equity-indexed annuities. Particularly troubling, regulators believe, is the use of these rather complex products with elderly investors, in large part because some of them have high fees and lack liquidity.

“We’ve found that a single-premium product works extremely well for this,” Ballou says. “There’s no surrender charge. You pay the premium once, and there are no expenses after the initial pay-in.” There’s a loading factor on the front end, but you break even in year two, he says.

### **Some charitable uses**

Advisors are finding a secondary use of the product in the charitable market, Ballou says. “People don’t want to disinherit their children, but they want to make a contribution to a charitable organization,” he explains. So they put a couple of hundred thousand dollars into a single-premium whole life policy, and donate the dividend to charity. The death benefit goes to the children, but meanwhile, they maintain control of the money. They can get a tax deduction to offset the possible tax gain they’re getting, and they can leave a legacy. Beyond that, the charity benefits during their lifetime.

#### **ADVISORS ARE FINDING A SECONDARY USE OF THE PRODUCT IN THE CHARITABLE MARKET.**

The charitable use can be parlayed into an additional sale. “We have some folks in the charity saying, ‘We really like the money, but wouldn’t it be nice if we had some of the death benefit?’” Ballou says. “So the charity can take that annual donation and buy a policy on the donor. If it’s a couple thousand dollars a year on a 60-year-old, then maybe it’s \$50,000 or \$60,000 or \$100,000 of death benefit. Then the

charity gets a steady stream of income to pay for the policy.”

So whether your clients or prospects are young or old, well-off or not, there is a lot you can teach them that just as orange juice is good all day long, so can life insurance deliver benefits in new ways—at any stage of their lives.

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