

Using permanent life insurance to help with retirement planning

Case study

A strategy for small business owners

Quick look

Planning for a future that seems far away can be difficult in the busy mix of everyday life. As a financial professional, you help simplify the complicated. See how life insurance can help your clients make a smart plan for their family and their future retirement.



The situation

Your client is a 38-year-old owner of a small restaurant. She is married and together her and her husband have two children.

As she thinks ahead, she's worried her family would have a difficult time continuing their current lifestyle should she die prematurely. Good economic times come and go, and she may not be able to fully rely on the success of the business for her future needs. Having lived through a recession and recent market fluctuations, she isn't overly excited about a direct investment in the market.

The restaurant doesn't offer a retirement plan because of the cost and administration involved in offering a plan for a small business. She's concerned about whether she can maintain her lifestyle in retirement. She's counting on the value of her business to fund retirement but its value is unpredictable. There's no certainty a buyer will be available when she reaches retirement and she won't know what the final figure will be until she tries to sell.

Is there a way to help your client financially protect her family now while helping her supplement her retirement dreams later?

A solution

She decides on a life insurance policy that will offer death benefit protection should she die prematurely along with the potential to accumulate cash values that may be accessed during retirement.

- **Immediate death benefit protection.** She gains death benefit protection as soon as the policy is in-force allowing her beneficiaries to receive a death benefit generally income tax-free¹ should she die prematurely. The policy also provides death benefit protection in retirement as long as the policy stays in effect.
- **Less restrictive.** Life insurance is not a qualified plan. Your client can make premium payments that are not subject to limitations associated with tax-qualified plans up to guideline premium payments. Also, any cash value grows on a tax-deferred basis.²
- **Generally tax-free distributions.**¹ She can access accumulated cash values within her policy in her retirement years generally income tax-free in the form of loans and withdrawals,^{3,4} as long as the policy is not a Modified Endowment Contract (MEC).⁵ Withdrawals are income tax-free up to the cost basis.

- **No penalties for early access and no required minimum distributions.** Should she need to access the policy's cash value before retirement, she can do so without a tax penalty associated with certain tax-qualified plans.¹ Plus, should she later discover that she doesn't need to access the cash value, she's not required to take distributions and may then leave the full death benefit as a legacy for her two children.

Considerations

- **Modified Endowment Contract status (MEC).**⁵ A policy that is considered a MEC may be subject to tax when a client accesses the cash values with loans or withdrawals.^{3,4} This type of structure is not recommended when putting together a retirement planning strategy.
- **Non-guaranteed performance.** Cash values for loans and withdrawals in later years may be more or less than originally illustrated.^{3,4}
- **Surrender charges.** Withdrawals may be subject to surrender charges and the amount available for policy loans.³
- **Loss of premium.** Depending on funding, life insurance may not guarantee avoiding loss of premium.
- **Specified amount of coverage.** Two considerations:
 - Will the the specified amount be enough to meet your client's pre-retirement life insurance needs?
 - Should your client leave room to add more premium in the future, if desired? Having a specified amount larger than necessary may limit potential cash value growth for retirement income.
- **Cost of insurance.** Permanent life insurance policies require monthly deductions, which include cost of insurance, expense charges, and potentially other charges. These deductions may reduce the cash value of the policy.

Need help with your retirement planning cases?

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2. The tax-deferred feature of universal life or indexed universal life insurance is not necessary for a tax-qualified plan. In such instances, your client should consider whether other features, such as the death benefit and optional riders make the policy appropriate for the client's needs. Before purchasing a policy, your client should obtain competent tax advice both as to the tax treatment of the policy and the suitability of the product.
3. In some situations, loans and withdrawals may be subject to federal taxes. Clients should be instructed to consult with and rely on their own tax advisor or attorney for advice on their specific situation.
4. Income and growth on accumulated cash values is generally taxable only upon withdrawal. Adverse tax consequences may result if withdrawals exceed premiums paid into the policy. Withdrawals or surrenders made during a Surrender Charge period will be subject to surrender charges and may reduce the ultimate death benefit and cash value. Surrender charges vary by product, issue age, sex, underwriting class, and policy year.
5. For most policies, withdrawals are free from federal income tax to the extent of the investment in the contract, and policy loans are also tax-free so long as the policy does not terminate before the death of the insured. However, if the policy is a Modified Endowment Contract (MEC), a withdrawal or policy loan may be taxable upon receipt. Further, unpaid loan interest on a MEC may be taxable. A MEC is a contract received in exchange for a MEC or for which premiums paid during a seven-year testing period exceed prescribed premium limits (7-pay premiums).



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