USING LIFE INSURANCE FOR RETIREMENT PURPOSES

March 7, 2018 by David Kleinhandler

When people hear the words "life insurance," they immediately turn away from even discussing the matter. But what they may not understand is that it's an asset — there to provide a stream of cash to help fund retirement tax-free and to pay for long-term care if you become ill.

The one fear we all have when getting close to retirement, even with all our planning, is whether we'll have enough to last us through it. When doing your planning for retirement, you need to accept the reality that you could be retired for a long time and, if married, your savings may need to last for two lives — not just one.

As you prepare for retirement, the money you are saving should be considered "safe money," or funds you put away in secure conservative investments that will protect you from stock market volatility. What if you could invest and put the risk on the carrier and have downside protection? There are certain rules that will allow you to maximize the cash accumulation in your policy by following the 7702 guidelines, essentially funding to the maximum allowed under these guidelines. It's basically creating a safe harbor without creating any penalties. Only an astute life insurance professional would know how to position these types of features correctly.

As you are contemplating retirement, it's a common exercise to simplify your life by eliminating some of the things you no longer need. For example, you can eliminate monthly commuting costs and stop making contributions to the company 401(k) plan. If your kids are all grown and you're on the verge of becoming an empty-nester, take a look at your home expenses and begin to think about a less expensive alternative. You may even consider canceling some or all of your life insurance policies. This is where you need to stop and realize exactly how the policies you currently own may have some value in your retirement.

As the nest begins to empty out, the need for life insurance begins to diminish. When you originally purchased your policy, you were probably looking at it as an income replacement tool to protect your family in case something happened to you and your income was lost. But, it is unrealistic to think that you may not still need that protection in retirement. Many retirees decide to re-enter the workforce for a variety of different reasons: to keep busy, for social interaction and to supplement their incomes. If that supplemental income is important to your retirement, your policy can continue to provide the same protection to your spouse during this period.

Your policy can also replace any income derived from your pension benefits, which may be either significantly reduced or eliminated entirely upon your death. The same holds true for social security benefits. When you pass away, your surviving spouse will only continue to receive the highest of the two benefits. The lower one will cease to exist.

In addition to income replacement, there are several other ways those policies you purchased can be beneficial to your retirement:

• **TAX-DEFERRED GROWTH:** If you purchased a permanent insurance product (whole life), then you've been building up cash for the entire time you've had it, and it has been growing on a tax-deferred basis. The dividends earned are considered a return of the premiums you've paid and are only taxable if the dividends exceed the premiums paid. You will not be required to pay any taxes until the policy is surrendered.

• **USING DIVIDENDS TO PAY PREMIUMS:** If you choose to keep the policy going for the tax-deferred income or death benefit, the earned dividends can be used to pay the premiums on your policy. By doing this, you immediately free up some additional cash in your budget.

• **WITHDRAWING FROM OR BORROWING AGAINST THE CASH VALUE:** When you have a policy that includes a cash value, your family will only receive the death benefit and not the cash value that has been building up in the policy. It could be beneficial to you to use that cash value during your retirement. You can access portions of the cash tax-free if the amount taken is less than what you paid in. Anything more than that would be taxable. You could also borrow against it and choose to have the loan and interest repaid from the death benefit after you die. Note that this is also not taxable if the policy lapses or has been surrendered.

- **CONVERTING TO A LIFE ANNUITY:** Many carriers will allow you to surrender your permanent product and use the cash to purchase a life annuity product. This can prove to be an effective strategy, assuming there are no major tax implications.

- **LONG-TERM CARE:** If your situation is financially stable and you are more concerned about long-term care, you may want to convert the cash value in your policy to a policy that contains a long-term rider in it. You may even be able to do it on a tax-free basis.

As you get older, your priorities will change and so will your life insurance needs. The best way to manage these changes is to be proactive and work with a financial professional to come up with a strategy that will help you reach your goals.