FOX BUSINESS

Thursday, April 19, 2012 ©2012 FOX News Network, LLC. All Rights Reserved.

Using Life Insurance to Fund Your Retirement

By Lynnette Khalfani-Cox

When people buy life insurance, it's mainly to leave money behind for a spouse, children, other relatives or close friends.

But an increasing number of middle-aged and senior Americans are looking at life insurance for the financial benefit it can provide during their golden years. Some savvy savers and investors are using permanent life insurance to help fund a more secure retirement.

Three varieties of permanent insurance -- also known as cash value insurance -- offer policyholders a chance to supplement their retirement income:

- Whole life insurance offers a guaranteed interest rate from the insurer, plus potential dividends that are based on numerous factors, such as the insurer's business performance. To receive dividends, the policy must be issued by a mutual life insurance company. Returns for whole life insurance policies usually are in the 4.5% to 6% range. They typically have minimal guarantees of 3% to 4%, which may be enhanced by dividends.

- Universal life insurance has a fixed-rate component, typically offering policyholders a minimal annual return, after deductions for expenses, in the 3% to 4% range. Returns can be slighter higher, but contractual guarantees on these policies typically establish a preset minimum return. Universal life gives you the advantage of flexibility: You can increase or decrease the death benefit, and vary your premium payments. See more in Insure.com's life insurance basics.

- Variable life insurance policies are linked to the equity and fixed income markets. So just as your 401k money can fluctuate as stocks or bond prices rise or fall, so too can investments within a variable life insurance policy. Over time, good-performing variable life policies may achieve annual returns in the 6% to 8% range for customers.

Permanent life insurance is gaining popularity as a retirement funding option due to pure economics.

"In today's world of a zero-rate environment, many people are saying, 'I'd be willing to accept a 3% to 5% return on my money,'" says Adam Sherman, the CEO of Firstrust Financial Resources, a wealth management firm in Philadelphia.

Sherman says the tax advantages of life insurance also make it an attractive option for those in retirement.

"All the growth, or appreciation, that happens inside a life insurance policy is protected from current taxes. So it grows tax-deferred," Sherman says.

Jean Dorrell, president of Senior Financial Security Inc., a retirement and estate planning firm based in Florida, agrees.

"If you own a variable universal life policy -- and that's what I have -- they can be very good for retirement income tax free," says Dorrell. "If you overfund it," she adds, "in 15 years' time you can withdraw it tax-free, under IRS guidelines." Overfunding a policy means you put extra money into it, in excess of the premiums due. You can then use the excess cash value in your later years.

Plus, when you take money from the cash value account of a life insurance policy, you

don't have to sell the asset, as you do with stocks. When you withdraw an amount no greater than your cost basis (the amount you have paid in premiums) or borrow money from the policy, you don't have to pay capital gains and ordinary income taxes, as you would if you'd sold stocks or bonds to raise cash during retirement.

Creditors can't get it

"There are very few assets you can own that are tax-free and creditor-proof. Life insurance and annuities are among them," Dorrell says.

That's one reason you should never take money from life insurance to pay off debts during retirement, Dorrell cautions.

"You don't ever want to touch it when you've been sued or have judgments against you from, say, a credit card company or a mortgage lender," she says. "In most cases, your life insurance is 100% protected from creditors. So if you pull cash value out of there, you're going to subject that money to possible seizure by a creditor."

 ©2012 FOX News Network, LLC. All Rights Reserved.

Getting your money out

Getting money from your life insurance policy is fairly simple, Sherman and Dorrell say. You start by calling your insurer and finding out how much cash value is in your policy. You can usually borrow up to 90% of the "cash surrender value" of a permanent life insurance policy, and funds can be distributed in a lump sum or annually. Some insurance companies may allow you to borrow slightly more than 90%, so if you require more, ask your insurer about your policy's specific guidelines.

Borrowing the full 100% of your cash surrender value usually is not allowed, because having no cash value can cause your policy to lapse.

Some permanent policies might take two to three years to fund before there's any cash available at all in them for withdrawals or loans. It typically takes 15 or more years to accrue enough cash value in a policy to offer a meaningful retirement income stream. But once you've built up cash value, getting the money out is straightforward. There's no approval process nor are there any taxes on what you withdraw. One caveat is "if you're depleting your cash value and it's not considered a loan, that is going to be a taxable event," Dorrell says.

Loans from the cash value must be repaid, along with interest to the insurance company. With universal or variable life insurance policies, loan rates generally average about 1%, Sherman says. For whole life insurance, rates are higher -- usually in the 5 to 6% range, and older policies might even be higher -- due to how those policies were set up contractually.

Loan-repayment rates are tied to the investments an insurer would have made, had you left the cash value in a permanent life insurance policy, rather than taking out a loan. When variable life policies have lower loan rates, it suggests the insurer intended to invest the funds in money-market instruments or cash equivalent securities. Meanwhile, whole life policies requiring a higher loan rate mean the insurer planned to invest the money in more aggressive instruments, such as stocks.

A life insurance withdrawal does not have to be repaid, but it reduces the death benefit your heirs will receive by the amount withdrawn.

The original article can be found at Insure.com: *"Using life insurance to fund retirement"*