INDEXED UNIVERSAL LIFE INSURANCE

A vehicle that may also increase your retirement savings potential.

Presented by Margaret Seabrooke

Indexed universal life insurance has gained popularity with business owners, executives, retirees and families. Why? It allows you to build cash value with protection from downside risk.

There are advantages and disadvantages to an IUL policy, as with any insurance product, but it may appeal to people looking to accelerate retirement savings and promote retirement cash flow.

IUL in a nutshell. IUL combines life insurance coverage (and a death benefit) with a tax-deferred equity index account that builds up cash value.

A percentage of your IUL policy premiums fund annual renewable term insurance. The balance is added to your policy's cash value account. The account return is actually an index-linked interest credit reflecting the performance of a major Wall Street index: the S&P 500, the NASDAQ 100 or something similar. (You can usually pick an index from a few choices.) Unlike a variable universal life policy, the assets within the account aren't allocated among equity positions.[1]

Annual returns are "guaranteed" never to be negative. An insurer issuing an IUL policy makes a pledge to the policyholder: even if the index linked to the policy's cash value declines, the cash value will not.

Gains are amassed based on the policy's participation rate, which is established by the insurer. The participation rate equals the percentage of exposure of the cash value to the equity index. For example, let's say a policy has a current cash value of $50,000 and the linked index gains 6% in a year. If the participation rate is 50%, then $1,500 is added to the cash value [(6% x 50%) x $50,000 = $1,500].[1]

There is a chance for tax-exempt retirement cash flow. IUL policies may be funded with after-tax dollars, meaning that the cash value can later be accessed tax-free. Currently, there are no limits on the amount of money that can be placed into an IUL policy. A family, business or executive can direct variable amounts into the policy annually, so there is some nice flexibility.[2]

The caveats to IUL. An IUL policy calls for a long-run outlook. The cash value may be less than the premiums paid for years after the policy's issue, and surrender charges may be applicable 10-15 years into the life of the policy. Additionally, the ability to flexibly fund the policy year-to-year can be a curse if inconsistent premium payments lead the policy to lapse.[3]

Mortality charges have to be deducted from the contract value of an IUL policy, and those charges and the interest crediting formula for the policy could change upon management decisions at the linked insurance carrier.[3]

While the annual interest credit on an IUL policy will never be negative, most IUL premiums are invested in bonds by insurance companies. So over the long haul, the rate of return on the savings component of an IUL policy may mimic the fortunes of the bond market – and if stocks do better than bonds, that's not optimal.[3]

All this considered, however, IUL equals an intriguing option for business owners, key employees and their families: an insurance option worth examining.

Margaret Seabrooke may be reached at 203.481.1040 or peg@margaretseabrooke.com.
margaretseabrooke.com

Citations.

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