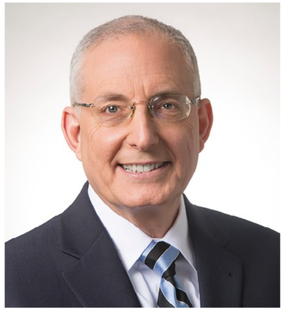

ED SLOTT'S

IRA ADVISOR

Tax & Estate Planning for Your Retirement Savings

February 2021

Ed Slott, CPA; Ed Slott's IRA Advisor; and Smart Subscriptions, LLC has granted permission to David Buckwald, CFP®, CLU®, ChFC®, CLTC®, NSSA® to transmit the following article, written by David Buckwald, CFP®, CLU®, ChFC®, CLTC®, NSSA® in any format, by any means.

The New Ways to Advise Clients About Life Insurance

Guest IRA Authority

David Buckwald, CFP®, CLU®, ChFC®, CLTC®, NSSA®

OneTeam Financial
Cranford, NJ

The SECURE Act, with its 10-year limit on tax deferral by most non-spouse beneficiaries, has impacted the relationship between life insurance and IRAs.

Some clients have even considered withdrawing IRA dollars at the seemingly low tax rates today and using the proceeds to fund a life insurance policy. The payoff can be tax-free death benefits to children or even grandchildren. This can be a creative strategy to turn potentially higher-taxed assets in the future into tax-free inheritance passed to heirs in the future.

Rising in the East

While the SECURE Act has generated upheaval in estate planning for IRAs, a similar transformation is taking place in the life insurance industry. A year ago — *February 2020* — New York State's Regulation 187 went into effect with regard to life insurance. (Annuities were covered by this regulation in 2019.) Now, advisors must act solely in the "best interest" of their clients when it comes to life insurance transactions. This rule applies to modifications of in-force policies as well as to new policy sales.

Moreover, New York's best interest rule applies to life insurance policies delivered or issued for delivery in the state. Besides sales or policy modifications involving current residents of New York, it could involve former residents of New York with a life insurance trust created there, those with a New York trustee of such a trust, those with a New York advisor, or others with a tangential connection to the state.

In addition, New York has been a bellwether when it comes to insurance regulation. Already, several other states are in various stages of adopting similar rules. The SEC's Regulation Best Interest, which also took effect last year, may impact certain advisors involved in helping clients with life insurance decisions.

The bottom line is that acting in a client's best interest when advising about life insurance is a powerful trend that is upending traditional methods of recommending certain policies.

Dark Times for Illustrations

In particular, best interest rules frown on relying solely on life insurance policy illustrations for advising on purchases. Commonly, side-by-side comparisons are used to decide between two supposedly similar policies. The policy that shows the desired death benefit or cash value with the lower premiums would most likely be chosen.

Acting in a client's best interest when advising about life insurance is a powerful trend that is upending traditional methods of recommending certain policies.

However, some observers contend that over 80% of all permanent life insurance policies have underperformed their original illustrations, which were presented at the time of sale.

Questionable projections of future results within the policy might have led buyers to false hopes. Instead of building up a substantial cash value and having the policy stay in force for the insured individual's lifetime, some policies now may be in danger of lapsing.

Consequently, policyholders now might be called upon to make significant premium payments to keep the policy in force, when they can least afford to do so.

Join the Retirement Planning Conversation

ORDER AT **IRAHELP.COM/NEWSLETTER** OR CALL **(877) 337-5688**

Many agents are stuck in these outdated sales techniques — *using side-by-side illustration comparisons* — so they're playing the illustration beauty contest game. Elsewhere, there has been a relentless trend towards best interest standards across all financial industries; now it's time for life insurance. Unfortunately, life insurance has been one of the poorest performing asset classes in recent decades.

For advisors who recommend policies based solely on illustrations, the results of such underperformance can be dire. Not only will affected clients be unhappy, they might bring lawsuits. If best-interest rules cover a policy purchase or modification, reliance solely on a comparison of policy illustrations most likely won't be a justifiable defense.

Cost Control

If comparing policy illustrations does not qualify as due diligence, what should advisors do to evaluate life insurance? Regulation 187 requires policy choices to be based on what I refer to as performing CPR on a client's portfolio. This means doing a complete review of all charges and expenses, determining whether the expected performance is based on reasonable assumptions, and deciding if everything in the policy is in line with the client's risk tolerance.

Among those factors, policy costs may be the most important. The less paid for a given level of coverage from a reputable insurer, the greater the probability of success. Thus, all charges and expenses should be fully disclosed and benchmarked, which usually has not been the case unless such information has been specifically requested.

In terms of performance, the assumed rate of crediting within the policy should line up with reasonable and historic standards. *After many years of low interest rates, what returns might be reasonable to expect from whole life or universal life policies?*

Higher returns might be possible from policies where cash value growth is linked to equities, but any caps on those results should be considered when deciding whether the policy's anticipated growth is reasonable to assume.

Depending on how historic performance compares with assumed growth, a policy under review may be more or less risky. The best-interest process seeks to have advisors align the policy's risk level with the client's risk tolerance. To determine whether a particular policy is suitable for a particular client, advisors should learn about a client's age, income, existing assets, financial experience, liquidity needs, financial time horizon, tax bracket, etc., and find an appropriate match.

> The best-interest process seeks to have advisors align the policy's risk level with the client's risk tolerance.

An indexed universal life (IUL) policy might assume 7% growth, for example, and indeed could achieve such results if the underlying index does well over the coming decades.

That's not a sure thing, though, so such a policy might be considered to be relatively high-risk. A client who is willing to accept such risk may be an acceptable purchaser. However, clients who are extremely conservative about their personal finances could be better served with a different, less ambitious policy, run with more conservative growth assumptions, perhaps around 5%.

Checking Under the Hood

Consider how best-interest due diligence might be done. Take for instance a case where a 45-year-old client desired permanent life insurance with a $1 million death benefit and ample cash value potential. Two policy illustrations were examined, both displaying an assumed 5% rate of return, for an "apples-to-apples" comparison. Premiums were to be payable for 20 years, with projections for 50 years.

The universal life (UL) illustration showed annual premiums around $8,500 while the IUL policy required $13,000 per year. Thus, the UL policy would be better. *Right?*

In this case, not necessarily.

Going over the numbers in the illustration, the total fees for 50 years for the UL policy — *premium loads, fixed administration charges, cost of insurance* — were nearly $1.15 million. The same illustrated charges for the IUL policy, for the same time period, were less than $825,000.

How is that possible? How could the UL policy charge much lower premiums for a $1 million life insurance policy when its illustrated costs were much higher than those for the IUL policy? The answer is that something else was involved. Here, the amounts credited were much higher than the posted 5%: for the UL policy, over 14%, in one selected year, for example.

Considering the likelihood of getting such a return, the lower cost IUL policy might be a better choice. That's especially true if the client is an informed, somewhat aggressive investor, prepared to take some risk in return for the chance to benefit from long-term stock market growth.

For the IUL policy, however, interest credited in a similar year was close to 8% — *lower than the assumed crediting rate of the UL policy but*

© 2021 Smart Subscriptions, LLC

still much higher than the posted 5%. When faced with such illustrations, an advisor might suggest that the client seek other quotes with a genuine 5% projected earnings rate. The more complete the disclosure, the better advisors can judge whether recommending a certain life insurance policy will truly be in a client's best interest.

Action Plan for the Advisors

- Suggest that clients request current, in-force illustrations of all their permanent life insurance policies, with all charges and expenses clearly disclosed. *(Warning: carriers usually will not provide these numbers unless specifically asked to do so.)* If a review raises an alarm, indicate that seeking a replacement policy may be worthwhile.
- Life insurance is one of the most neglected assets on most clients' balance sheets and should be reviewed on a regular basis, as is the case with other portfolio assets. Be aware that clients who fail to do this regularly could see their wealth transfer plans destroyed, hurting the people and causes they care about.
- Also, for clients seeking new life insurance, recommend they ask for policy illustrations with complete disclosure of all costs and assumed crediting rates.
- Advisors may choose to crunch the illustration numbers themselves or turn to an external firm experienced in such analysis. A review from an independent consultant may help to avoid problems such as lagging cash value, policy lapses, and significant premium increases later in life when clients may least afford it.
- Explain to clients that just as Morningstar reviews investments, providing a way to compare pricing and performance, there are also places to go for examining all the costs and expenses of life insurance, reviewing whether performance has been in line with historical standards, and indicate whether taking the risks are in their best interest.

Retain all materials that show you actively pursued a life insurance policy that would deliver the desired protection at a competitive cost. ■

Dave Buckwald, CFP®, CLU®, ChFC®, CLTC®, CEO & Founder has been providing financial advice and guidance to clients for more than 30 years. He works with individuals, families and business owners to help them achieve their financial goals so they can spend more time doing what makes them happiest. His mission is to help clients preserve the wealth that's taken a lifetime to build with specialties, including life insurance, estate planning and wealth transfer strategies.

Losing his own father at the age of 17 with no life insurance or legal documents in place, Dave has experienced firsthand the complications and stress that come from lacking an organized and coordinated written financial and retirement income plan.

On September 11, 2001, this feeling was exponentially magnified at the loss of 51 friends and clients in the North Tower working for Cantor Fitzgerald, one of the largest brokerage firms on Wall Street. Of those, 30 had individual life insurance policies with Dave, but unfortunately, 21 did not for various reasons, mostly because they just never got around to it. In those months that followed, he witnessed how his friends' and clients' lives turned out for their loved ones who were left behind. The difference between those with proper planning and those without was life-altering and profound.

These experiences combined have filled Dave with a steadfast commitment and unparalleled passion that drives his vision for OneTeam Financial: To make sure that no family or business of ours will ever be left unprotected and not have their whole financial house in order. With his leadership, the company has continued to expand its team of specialists to deliver a knowledgeable and coordinated, holistic financial planning experience to its clients and community.

Highly respected among fellow advisors for his expertise and passion for service, Dave is a sought-after speaker at industry conferences around the world as well as a media resource. His insights have appeared in numerous outlets and publications, including Good Day New York, Private Wealth, New York State Bar Journal and Ed Slott's IRA Advisor. Dave regularly provides educational workshops and webinars for civic groups, professional organizations and other members of the community. Through these forums, he shares practical tax and wealth transfer strategies and expert insights on how to keep together what has taken a lifetime to put together.

An active advocate in his community, Dave is a board member of Hackensack Meridian Philanthropic Foundation and active in the Two Hundred Club of Union County, New Jersey, a charitable organization benefiting widows, widowers and families of fallen police officers and firemen.

For more information, visit oneteamfinancial.com or you may contact Dave at (908) 653-7292 or email him at dave@oneteamfinancial.com.

**This material is for informational purposes only and is not intended to provide specific advice or recommendations for any one individual. Individuals are advised to consult their respective qualified legal, financial or tax professional as appropriate.*

This material is intended for use by industry professionals and is not intended for use with or distribution to the general public.

Securities and Investment Advisory serviced Offered Through M Holdings Securities, Inc. A Registered Broker/Dealer, and Investment Advisor, Member FINRA/SIPC. OneTeam Financial, LLC is independently owned and operated. 3578657.1

© 2021 Smart Subscriptions, LLC