Do You Need Life Insurance in Retirement?

By JEFF VOGAN, RFC, CEP
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One form of life insurance that may be worth investigating for its tax advantages and estate benefits is an indexed universal life policy.

Many people I meet with ask me if they'll still need life insurance after they retire. Their children are grown and have good jobs. They have put together a reasonably solid income plan with Social Security, pensions and annuities supplemented by investments and retirement accounts. Their surviving spouse will have plenty of money if they die prematurely. So, does life insurance remain a must?

The short answer, under those circumstances, is no. Probably not. If no one is going to be left without resources when you die, your death benefits aren't as big of a deal as they used to be.

But it's a little more complicated than that. Because the tax benefits of a life insurance policy could be a very big deal.

Life insurance companies use a favorable tax code (section 7702) to give pre-retirees and retirees another tool to grow their money safely in retirement. Indexed universal life policies (IULs) are permanent insurance policies that can provide guaranteed tax-advantaged lifetime income in retirement along with several other benefits, including long-term care and terminal illness coverage, disability coverage and tax-advantaged wealth transfer and estate planning.

IULs are designed to be permanent life insurance policies. If you keep the policy in force, — which could involve such things as continuing to pay premiums and not letting it lapse by taking too much money out of it — your beneficiaries will receive the death benefit tax-free. Meanwhile, your policy's cash value will grow tax-deferred and, if funded correctly, can provide a tax-free income stream to you through loan provisions. Any amount you borrow is treated as if it's still there when interest is credited. You can borrow against the accumulation portion of your policy, and as long as you keep the policy in force, the money doesn't have to be paid back until you die — when it will come from the death benefit tax free. If the policy lapses due to bad performance, lack of other loan provisions or no lapse guarantees, you may have to pay taxes on the gains you have made. In other words, your loans become withdrawals and may be taxed.

IULs are considered a conservative asset class. A portion of the policy is indexed to a sector of the stock market, although gains are often capped in some way. So your money will grow, but the principal or cash value is protected from losses when the markets don't perform.

You can use an IUL as a safe-money alternative to more traditional certificates of deposit, savings accounts or bonds. With return rates for CDs and money markets still hovering around 1% to 2%, IULs offer more upside potential but with some added liquidity and flexibility. Some have had historical returns of 6% to 7% or more over the past few decades, even when the stock market hasn't performed well.

It’s a pain-free way to add to your portfolio because there are no IRS or state tax penalties for taking money out before age 59½; you don’t have to pay back your loans until you die (as long as you keep the policy in force); there are no required minimum distributions for you or your heirs to deal with; there are no capital gains or taxable interest; and IULs aren’t included as provisional income when you’re figuring out how your Social Security benefits will be taxed.

There are a few other things to note: If you decide to cash out the policy, you will have to pay income taxes on the difference between the amount you've paid in premiums and the amount you receive if there is a gain. Also keep in mind that you may have to pay surrender charges if you withdraw more than a certain amount within the first few years after you buy the policy (often seven to 10 years).

IULs aren’t right for everyone. Some people cannot qualify for life insurance due to health reasons, and others may not have a need that can be met by an insurance policy — perhaps they don’t have anyone in their life who might need money when they die, or maybe they don’t have a tax problem that needs solving. You should talk to a trusted financial adviser about the contract, the fees and other details, such as whether there is a lifetime income rider available and what interest-crediting strategies can be used. Other factors to consider could include asking what are historical and expected returns, and what could cause the policy to lapse? Are there terminal illness riders or chronic illness riders that allow you to take the death benefit early?

But if you’ve been wondering about the role life insurance should have in your retirement plan, this type of policy is worth exploring.

Kim Franke-Folstad contributed to this article.

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Jeff P. Vogan is the president of Premiere Retirement and Wealth Management. He has a bachelor's degree in business management from Brigham Young University and has spent more than 30 years in the financial industry. Vogan is a member of the International Association for Registered Financial Consultants and is an independent financial adviser.