PLAYING OFFENSE WITH LIFE INSURANCE.

By Steve Parrish

“PLAYING OFFENSE” - We’ve all heard the sayings in sports that celebrate taking an offensive stance: “The best defense is a good offense,” “Overpower, overtake, overcome” (Serena Williams), and “I’d rather regret the risks that didn’t work out than the chances I didn’t take at all” (Simone Biles). It’s a truism that no game is won purely by taking the defense. Risk-taking is expected, and going on the offense is a given.

But when dealing with your own financial future, risk has real-world consequences. It can affect both you and your family’s financial well-being. Clearly, playing offense in finance requires a balancing of risk and reward. Prudent financial strategies should not only offer the possibility of going on the offensive when appropriate, but also provide a defense against unsustainable loss. One such prudent strategy is life insurance. In the right situations, life insurance can defend against risk while offering living benefits to help you go on the offensive in planning.

In sports, teams play both offense and defense. It's a carefully orchestrated blend of taking the initiative and protecting against loss. The balance is different when managing one's own wealth. When it's our personal wealth, we typically begin with a defensive strategy that addresses financial risk. First, we seek to minimize risk by locking up our valuables and keeping our emergency savings in a federally insured bank. Then, we try to avoid risk by staying away from dodgy investments and ducking aggressive tax schemes. And a third risk management tool is to insure risk—to pay a premium to have an insurance company cover the risk for us. In the domain of an individual's mortality, life insurance is the product we use.

Playing defense with life insurance

Not surprisingly, life insurance is commonly thought of as a form of financial defense. If you die, money becomes available for your beneficiaries. It's a defensive tool because the death benefit is a guardian of your family's financial security when you are no longer there to provide for them.

Life insurance is seen as something needed "just in case." It's a defense against the unthinkable. However, the unthinkable is real, and we should think about the specific ways life insurance can help:

1. Pay off debt – The death proceeds can be used to pay off obligations such as a mortgage, personal loans, or credit card balances. This helps your family stay in the same home and keeps your children from being burdened with your financial obligations.

2. Prepay future expenses – The life insurance benefit can pre-fund future expenses such as childcare and college expenses, ensuring that your children's aspirations can be realized.

3. Income Replacement – The death benefit provides a fund to help replace your lost income, thereby safeguarding your family's financial stability. Ongoing income helps to maintain the family's lifestyle by covering necessary expenses.

4. Pay final expenses – Life insurance plays a crucial role in covering final expenses at death. It steps in to defray end-of-life costs, including taxes and funeral expenses. This support relieves your family of the necessity of dipping into savings or having to sell assets.

Consider the mechanism that makes life insurance so valuable. This product is powerful because of its risk-pooling feature. Rather than having to personally set aside a large sum of money to cover the risk of a premature death, you can instead pay premiums to an insurer. These premiums are combined

with millions of others' premiums and invested by the insurance company. If you die prematurely, the insurance company can afford to pay the full death benefit because they have the capital and ongoing premiums created by a vast pool of insureds. The idea of spreading individual risk among a larger group of individuals is analogous to sports. Just as a soccer team will build a defensive wall to block a free-kick attempt, or a football team positions guards to defend its quarterback, life insurance combines the resources of the many to defend against the risk to the individual. It is an effective financial defensive strategy because it pools and invests premiums to pay benefits when needed.

Playing offense with life insurance

In real life, the differences between offense and defense can blur, and this is relevant to the way we deal with our personal finances. We can only assess where we're going by first determining where we're starting from. Clearly, families should proactively plan for a successful retirement, but they must still protect against the risk of a premature death. And they should start planning now, even if they need to start on the defensive.

We know life insurance is a defense against dying too soon, and it's natural to utilize this product to guard against mortality risk. A life insurance policy, however, can do far more. It's not only a product for when

things go wrong—it can also be used to help you go on the offensive.

If, in our financial lives, we were never told to go on the offensive, we'd simply stuff our hard-earned wages into a mattress, and only pull out money when needed. As consumers, however, we seek to grow our wealth by accepting risk. We lend money to others, we invest in businesses, we leverage through borrowing, and we let time value accumulate our wealth. When we do financial planning, we're taking the initiative by setting aside money currently in order to have it grow and be available in the future. In this context, life insurance premiums can be used as a proactive way to accumulate wealth and create a legacy.

In addition to the four defensive uses of life insurance discussed above, there are several time-tested uses for life insurance to position your wealth for a financial win. Consider these four ways life insurance can be used as a positive and proactive strategy in your financial plan.

1. Wealth accumulation – Permanent life insurance policies, such as whole life and variable universal life,[1] build cash value over time as you pay your premiums. You can build personal wealth with these tax-deferred policy cash value accumulations.

2. Tax-efficient income – Cash value life insurance policies can generally be accessed tax free through policy loans and withdrawals,[2,3] making it a tax-smart way to supplement your retirement income, or fund other large purchases, such as a down payment on a new home as policies mature and protection needs have changed.[4] It should be noted that accessing the cash value will reduce the cash value and death benefit.

3. Legacy/Estate planning – When it comes to estate planning, life insurance is a powerful ally, whether you die prematurely or in old age. It provides the needed liquidity to cover estate taxes and other estate settlement costs. This is particularly valuable if your estate is comprised primarily of illiquid assets such as a closely held business or real estate. Without life insurance, heirs may encounter difficulties in generating the funds necessary to pay the estate's taxes and expenses, potentially necessitating the sale of valuable assets. With life insurance, assets can transition seamlessly to the insured's heirs, eliminating the need to use them to cover estate liabilities.

4. Business continuity – In a business setting, life insurance is often used to fund buy-sell agreements. A funded buy-sell creates a market for the deceased business owner's interests while ensuring the smooth transfer of the company to the surviving business owner. This can protect against financial losses during difficult times for the company and safeguard both the business and business owner's financial stability.

Strategies for using cash value life insurance during your lifetime

The four "taking the offensive" life insurance strategies listed above have been used for decades to proactively support and enhance financial planning for individuals and businesses. Using life insurance in these ways helps initiate tax-smart funding approaches. In some cases, the death benefit of the life insurance policy is the key driver in making the product so useful. In other cases, the cash value feature takes center stage. Let's consider in more depth how cash value life insurance strategies can enhance individual and business planning.[5] A way to examine these strategies is to consider the three financial life stages many individuals go through as they age. The three stages are: 1) their working years; 2) their early retirement years; and 3) their elderly retirement years. Each of these phases calls for its own financial strategies.

1. The Working Years: While people are growing their careers and families, they rarely have idle cash reserves available for funding future plans. They will need to tap into some of their take-home pay to fund their long-term retirement growth plans. Additionally, taxes can have a dramatic effect on how much they can accumulate for the future. Most people experience their highest marginal income tax rates during their working years. Further, very few individuals have guaranteed jobs, and no one is guaranteed good health.

2. Early Retirement Years: Early in retirement, retirees' financial challenges are different from those they faced while working. First, they need to replace income that previously came from their paycheck. Second, if they retire before filing for Social Security, they will need additional income to support themselves until they can start receiving this important government benefit. Third, retirement-related taxes can appear in insidious ways. If they are middle-income retirees receiving Social Security, their marginal tax on these benefits may take a hit because of the so-called "Social Security tax torpedo."[6] If instead they are affluent, they may be burdened with the income-related monthly adjustment amount ("IRMAA") associated with their Medicare premiums. Contrary to popular perception, taxes don't disappear when wages cease.

An often-overlooked risk in the early retirement years is the sequence-of-return risk. Since most recent retirees are more likely to have a 401(k) than a traditional defined benefit pension plan, once they retire, they must draw down the assets in their portfolio to support their retirement lifestyle, and they must decide how much to withdraw each year. The drawdown must be enough to meet their income goals, but not so much as to run out of funds in the future. The sequence-of-return risk means that a few bad years of investment returns on their 401(k) balance in the early part of retirement will have an outsized impact on their remaining plan balance. Early losses will

accelerate the exhaustion of the retiree's funds, leading to inadequate —or no— income later in retirement.

3. Later Retirement Years: When truly elderly, retirees will have been supporting their retirement lifestyle with a 401(k) or IRA, and their balances may have been substantially reduced by this time. Additionally, they will be forced to take Required Minimum Distributions, once again increasing their potential tax bill. And importantly, the elderly individual may no longer want to—or be able to—handle their finances. At this stage in their life, their retirement plan should be simple.

Cash value life insurance can be a useful proactive strategy to address these challenges during the three financial phases of life. While the policy's death benefit remains key as a protection element, the building cash value can be a critical financial element in supplementing a retirement plan. During an individual's working years, the accumulating value offers tax deferral and a cash reserve. In early retirement, it provides a potential source of tax-free income. And late in retirement, the cash value offers options, and simplicity. The cash value can help address having a long retirement— and not just protecting against a shortened life.

Life insurance addresses more than the financial worry of "just in case." It's not merely a defense for when things go wrong.

And an insurance professional can help you with issues beyond "What if?" Armed with products and guidance, an agent can help you design a proactive financial strategy: a strategy that goes on the offensive.

In particular, cash value life insurance can both defend against unforeseen death and create wealth for a successful retirement. It can facilitate continuation of a business and provide peace of mind in old age. Packaged together with a thorough game plan, you can get out ahead of life's challenges and fund financial solutions that drive you closer to the goal line.

About the author.

Steve Parrish is the Professor of Practice for The American College of Financial Services, where he is a contributor to the WMCP®, RICP®, and ChFC® programs. In addition to his role at The College, he is an adjunct professor at Drake University Law School, where he teaches estate planning. Parrish is an expert in estate and financial planning, with a specialty in business owner issues. He is a recognized industry authority, spokesperson, and author, including as an ongoing contributor to both *Forbes* and the *Journal of Financial Service Professionals*. Parrish has served as an expert source for such prominent media outlets as *The New York Times*, InvestmentNews, MarketWatch, *The Wall Street Journal*, *HR Magazine*, and the *Journal of Financial Planning*. Parrish is a sought-after speaker with bar associations, estate planning councils, and state AICPA meetings. He has addressed such financial service organizations as MDRT, LIMRA, NAIFA, the Association for Advanced Life Underwriting (now FINSECA), and the Society of Financial Service Professionals.

This white paper is funded and provided as a courtesy by New York Life Insurance Company. The author's intent with this paper is to explain concepts, not to represent a particular policy or strategy for a particular client or situation.

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[1] Guarantees are based on the claims paying ability of the issuer and do not apply to the cash value of a variable life insurance policy which is subject to market risk, including a possible loss of principal.

[2] In the case of the whole life insurance design, when taking a withdrawal (surrender), you are surrendering any available paid-up additional insurance for its cash surrender value. This means that your whole life insurance policy's cash value, available cash surrender value, and death benefit will be reduced by the amount of the withdrawal. In the case of a variable life insurance design, when taking a withdrawal (partial surrender), you are surrendering a portion of your policy. This means that your variable universal life insurance policy's cash value, available cash surrender value, and death benefit will be reduced by the amount of the withdrawal, a processing fee, and any applicable surrender charges. The total outstanding loan balance (which includes accrued loan interest) reduces your policy's available cash surrender value and life insurance benefit. The amount you borrow will accrue interest daily. Any loan interest that you do not pay when due will be added to the policy's outstanding loan principal and will also accrue interest daily. If your policy lapses, or if you surrender it while you have an outstanding policy loan, you may be liable for federal or state income taxes. Any taxable gain would be reported to you, the Internal Revenue Service (IRS), and any applicable state taxing authorities. Please be sure to discuss this with your tax advisor.

[3] Certain tax advantages are no longer applicable to a life insurance policy if too much money is put into the policy during its first seven years, or during the seven-year period after a "material change" to the policy. If the cumulative premiums paid during the applicable seven-year period at any time exceed the limits imposed under the Internal Revenue Code, the policy becomes a "Modified Endowment Contract" or MEC. Also, a death benefit reduction during this seven-year period (e.g., because of a partial surrender), may cause a policy to become an MEC. An MEC is still a life insurance policy, and death benefits continue to be tax free, but anytime you take a withdrawal from an MEC (including a policy loan), the withdrawal is treated as taxable income to the extent there is gain in the policy. In addition, if you are under 59½, a penalty tax of 10% could be assessed on those amounts and upon surrender of the policy. In addition, withdrawals within 15 years after a policy is issued may be taxable to some extent if the death benefit under the policy is also reduced. You should talk to your tax advisor if you anticipate making withdrawals.

[4] It should be noted that it may take an extended period of time before a sufficient enough amount of cash value can be built up to be able to access for a significant expense.

[5] See "Bringing New Life to Your Portfolio: A Tax-Efficient Way to Grow Wealth" by Steve Parrish. https://www.newyorklife.com/assets/docs/pdfs/articles/AR11261_012023_Position_Paper_Adding_by_Steve_Parrish.pdf.coredownload.pdf

[6] https://smartasset.com/taxes/social-security-tax-torpedo

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AR11807.042024 SMRU6206300 (Exp.02.01.2026)