QUALIFIED INSANITY™

Is there a better way to save for retirement?

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Let me ask you…

Are you participating in a "Qualified (to pay taxes later) Retirement Plan" like a 401(k), IRA, or any of the other alphanumeric buffet of tax-deferred plans out there? Have you seen firsthand the devastation market losses can ravage upon your account values? Do you have any idea what kind of fees and expenses are hidden in your plan? Do you even want to think about the bite taxes will take when it's time for your partner Uncle Sam to take his cut? Ever wished you could use some of that money before 59½ without paying a penalty to touch your money?

Would you like to stop the Qualified Insanity™ & save for retirement differently? If so, keep reading…

Let's start with some history

In 1974, Congress passed the Employee Retirement Income Security Act (ERISA) creating "Individual Retirement Accounts" (IRAs), followed by section 401(k) of the Internal Revenue Code in 1978. At the time these laws were passed many employees were part of a defined benefit pension plan through their employer. Every year or pay period the employer would make a contribution to a plan and then at the time of retirement the employee had a regular payment he or she could count on for the rest of his or her life (a "defined benefit"). Additionally, most individuals were part of the Social Security system (as they are now, although confidence in the solvency of Social Security wasn't the widespread concern it is today). The qualified plan (i.e. the IRA/401(k)) was never meant to be an individual's primary retirement savings plan.

These qualified plans were not overnight sensations.[1] The rise of individual qualified plans can be attributed to two related, symbiotic forces: 1) Qualified plans were attractive to Wall Street from a marketing standpoint and 2) Employers realized defined benefit plans ("pensions") were expensive & saw an opportunity to get out of the retirement liability business.

Wall Street found a new market: the Middle Class. Forty years ago, Wall Street was still primarily the bastion of the wealthy. Mutual Funds have been around for hundreds of years in various forms and iterations but were not the "Main Street" product they are today. We certainly didn't have online brokerages, discount trading, exchange traded funds (ETFs), etc. in the same way we do today. We also had much higher statutory tax rates in the 1970s and early 1980s[2]. Fundamentally, one of the key advantages or selling points of qualified plans is they are tax-deferred, meaning contributions are not taxable in the current period. Employers sweetened the deal in many cases by offering matching contributions in some plans, like 401(k)s, only increasing their attractiveness.

Wall Street had something new to talk to Middle Class America about: a type of plan that they could put money into that meant they could reduce their current year tax burden. To an immediate gratification-focused public this was marketing gold. On top of that, these were employer-sponsored plans, so the banks and investment houses had **employers literally letting them in the door** giving them access to their employees so they could be "educated" about how these plans worked. Of course in time, this employer access was supplemented with huge consumer advertising. **The result: the public was being told (sold?) that participating in a 401(k) was as American as "Baseball, The 4th of July & Apple Pie."**

At the same time, employers were finding that traditional defined benefit plans were growing increasingly expensive & didn't fit with an evolving workplace. Life expectancies were increasing. The employer was the one with the liability (exposure) for making good on future payments, which created more stress on already stressed balance sheets. Employees were moving jobs more frequently, creating practical problems with the traditional

[1] A benefits consultant named Ted Benna is credited with in 1980 actually finding the loophole in Section 401(k) that was attractive for use as a tax deferred retirement vehicle for employees, "A Brief History of the 401(k)," *Time,* October 16, 2008.
[2] See http://taxfoundation.org/article/us-federal-individual-income-tax-rates-history-1913-2013-nominal-and-inflation-adjusted-brackets.

model. Progressive employers began to start getting out of the defined benefit world. Today only 11% of private sector employees are covered by a company pension plan.[3] Just in the first half of 2014[4], Boeing, News Corp. and Major League Baseball are a few examples of employers severely limiting or ditching their pension plans altogether.

Qualified Insanity™

While Qualified Plans have many positives (they are portable & encourage saving in general, which in and of itself is extremely positive; research indicates 28% of employees have less than $1000 saved for retirement; 43% aren't currently saving for retirement at all[5]), they have four major Wealth Eroders that can have a huge impact on your financial future (and these aren't the benefits Wall Street highlights in all their commercials):

- **EXPOSURE TO MARKET LOSSES**
- **EXPOSURE TO FUTURE TAX INCREASES**
- **COSTLY FEES & EXPENSES**
- **LACK OF LIQUIDITY**

Exposure to Market Losses

"Rule #1, Never Lose Money. Rule #2, Never Forget Rule #1." – Warren Buffett

Since 2000 the S&P 500® has had two years of declines greater than 20%.[6] In fact, going back to 1900, history suggests we can expect a market "correction" (decline) of at least 10% once every 3 or 4 years. History also suggests the market is nearly impossible to consistently time.[7]

Market losses aren't easy to recover. Consider that a 40% decline requires a 67% increase just to get back to even. A 40% increase following a 40% decrease is still down 16% overall, as you can see here:

Start = 100 **Down 40% (year 1)** End = 60 **Up 66.6% (year 2)** ↓ **End = 100 or (net, "even")**	Start = 100 **Down 40% (year 1)** End = 60 **Up 40% (year 2)** ↓ **End = 84 (net, down 16%)**

Unfortunately many market corrections occur at inopportune times. If you didn't need to access your money, you could have by now recovered your losses from 2008. Many people however didn't have that luxury. Even if they could have "stayed in the market," many did not out of fear of even greater losses. Legendary investor Warren

[3] *Retirement Plan Types of Fortune 100 Companies in 2012*, October 2012, Towerswatson.com.
[4] As of April 2014, per www.pensionrights.org.
[5] Helman, Ruth. "2013 Retirement Confidence Survey." *EBRI Issue Brief 384* (2013).
[6] 2002: -23.37%; 2008: -38.49%.
[7] "What past market declines can teach us." www.AmericanFunds.com.

Buffett[8] famously got wealthier by following his own sage advice, "Be greedy when others are fearful." That, and remember Rule #1!

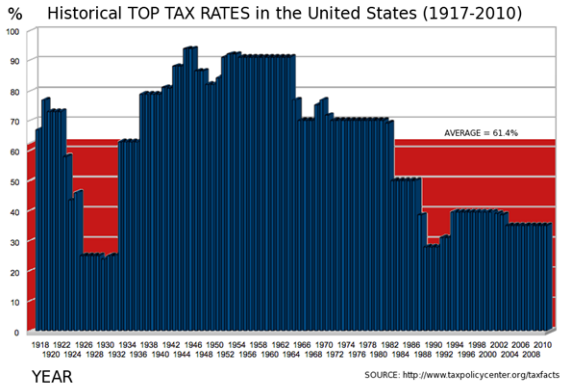
Exposure to Future Tax Increases

The conventional wisdom the Wall Street Propaganda Machine and government pumps at us is, "It's a good idea to save for retirement using a 401(k) because once you're retired your tax rates will be much lower because you won't be working."

There are two reasons you ought to at least reconsider that conventional wisdom. One of them you have little or no control over. The other one you may have a great deal of control over depending on your lifestyle.

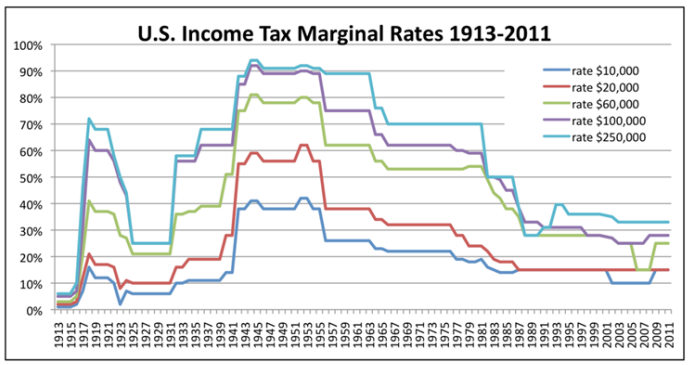
Statutory Rates

The one you have little to no control over is statutory tax rates. You see on your pay stub all those withholdings for taxes that your employer makes and you probably think you've got it pretty bad. How could things possibly get worse? **The reality is that right now we are in a period of historically LOW tax rates.** The highest marginal (top) rate is near record lows, as you can see here:



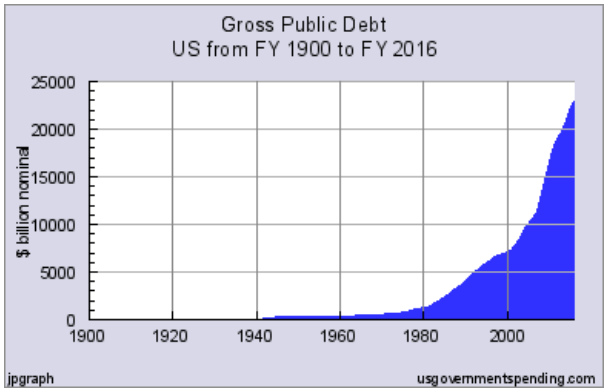
Okay, so you aren't in that top tax bracket or think you never will be? You're "middle class" folks, right? Here's a reality check: you are paying historically low rates as well. The effective rates on the middle quintile of earners are at historically low levels.[9]

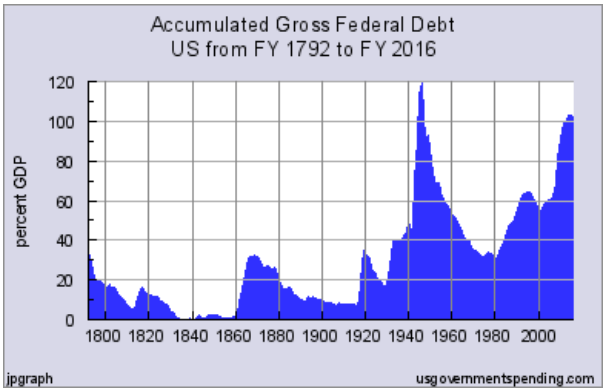
The chart below shows how statutory rates have gone down across income bands. So what's wrong with this picture? Nothing, if there were corresponding declines in government spending.



[8] http://www.goodreads.com/author/quotes/756.Warren_Buffett is a compilation of Warren Buffett quotes and a good starting point for anyone interested in learning from the wisdom of the legendary investor.
[9] Center on Budget and Policy Priorities. http://www.cbpp.org/cms/?fa=view&id=3151.

Instead we have record levels of government debt. In fact, our government debt now approaches our GDP:





Politicians, economists and other policy wonks will debate each other about what the "real, true" debt is (most of these numbers don't include unfunded obligations created by Social Security). This isn't meant to be a partisan political discussion, or to in any way get into the blame game. There are plenty of people out there doing that. Simply put, the question is: **do you believe our current level of money going in versus money going out (deficit) and the debt it is creating is unsustainable?**

In light of that, do you think statutory tax rates are likely to go up, down, or stay the same?

Your Own Individual/Household Tax Rate

The other part of this tax rate question has more to do with you and your individual situation. This one won't be the same for everyone and you do have more control over it based on your lifestyle. Conventional wisdom is that "in retirement you only need 80% of your pre-retirement income to maintain the same standard of living," or some similar rule of thumb.

Here's what's missing from that equation: Deductions!

- **Mortgage Interest –** this is a big one! Even though we're seeing more and more retirees with mortgages, this isn't part of the plan is it? *Your* retirement plan has that bad boy paid off, right?
- **Children – a double whammy** – they are both an exemption and a credit. Sure, your adult children may move back in and you may support them, but as adults they will be too old to qualify as dependents…sorry…
- **Retirement Plan Contributions –** you know 401(k)s and other "qualified (to pay taxes) plans?" In retirement, those deductions go away…in fact, if you are taking a distribution, that's where a great deal of your "income" may be from…

Add all those up and any decline in spending is more than offset by bigger declines in income.

The other piece is quality of life/spending. More available time means more available time to do things, and doing things costs money. Many leisure activities are expensive. This isn't to say "don't spend." After all, being able to do things you want to do (or at least afford to do them) in retirement is aspirational. Just be realistic about what your retirement lifestyle will be like.

All told, the prospect of higher statutory tax rates in the future that aren't offset by a lower retirement tax bracket means tax-deferral may not be the bargain it appears to be on the surface.

Costly Fees & Expenses

According to Secure Retirement Institute (SRI) research, 50% of Qualified Plan participants have no idea what they pay. Nearly 40% of participants in a qualified (to pay taxes later) retirement plan like a 401(k) think they don't pay any fees and expenses at all. Only 12% were able to estimate a close approximation of what they thought they were paying. The survey results were released after the Department of Labor's much publicized fee and expense disclosure regulations went into effect. The research indicates these disclosure regulations have had little to no meaningful impact on participants' understanding of fees and expenses.[10] Looking at the impact of fees in a different way, separate research indicates a median income ($50,000) family could pay $150,000 in 401(k) fees and expenses over the course of a lifetime. That's 3 years of annual income![11]

Types of Fees

There are two main types of fees that contribute to the overall cost of having (participating in) a 401(k). The first is actual plan fees and expenses. This may include the costs of administering the plan as well as investment management. The Society for Human Resource Management reports this is, on average, 1.4% for all employers, 1.5% for small plans (<50 participants) and 1% for large plans (>1000 participants).[12] What they still leave out of the equation are all the fees and expenses of the underlying assets, often professionally managed mutual fund shares. **These fund expenses and fees can take another 1 or 2 percentage points (or more)[13] out of your actual return.**

What Does It Mean?

What does a 2% or 3% total fee mean over the long haul? Consider this purely hypothetical example. Ignore type of plan, fund or any taxes; this is just math:

An individual contributes $500/month ($6000/year) to something for 30 years. At the end of that 30 years if he got an 8% rate of return he'd have $734,075. What if he paid 3% in fees and expenses, meaning he only realized a 5% return? He'd have $418,565, or 43%, less! Only 2% fees & expenses or 6% return? He'd have a slightly better $502,810, or only a 32% haircut.

Check Your Own Funds!

Talking about "average" fund fees and expenses or discussing what someone else is paying really is just trivia. **The real question is: what are *you* paying?** You can find out what the expenses are in your funds with the FINRA Fund Analyzer.[14] Remember these are just the fund expenses. On top of those you have the actual 401(k) plan expenses. **Worth noting, no one has ever produced credible evidence that over the long term, higher fees drive better performance.** In fact, study after study on investment returns has shown that actively managed funds, on average, fail to do any better than indexed funds.[15]

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[10] Robert Powell. http://www.marketwatch.com/story/7-worst-401k-mistakes-by-retirement-savers-2014-03-08?pagenumber=1.
[11] Domos. http://www.demos.org/news/can-index-funds-fix-your-401k-fee-problem. (As an aside, these figures may be low as the assumptions suggest a relatively low-cost plan).
[12] SHRM. http://www.shrm.org/hrdisciplines/benefits/Articles/Pages/401k-Feeseclined.aspx.
[13] The actual "average total fees and expenses" in a professionally managed fund is probably never going to be a number everyone can agree on, nor is it particularly meaningful. What's more, the variation is quite high. What is important to an individual is what they are actually paying. Some dated (2007) research suggests it could be 3.7% or more. See "Uncovering Hidden Fees in Qualified Retirement Plans" 3rd Edition, Fall 2007 Illinois Elder Law Journal.
[14] http://apps.finra.org/fundanalyzer/1/fa.aspx is the link to the FINRA Fund Analyzer. Enter your fund's ticker symbol or search by fund name (you should be able to find this on a statement) and see what your fees and expenses look like.
[15] *A Case For Indexed Fund Portfolios*, Ferri & Benke (2013). www.rickferri.com/WhitePaper.pdf.

In fairness to fund options in qualified plans, like 401(k)s, there are a number of very low fee/expense index funds. You still have the plan expenses but at a large company these can be well under the 1% average and you have very nominal (.2% or thereabouts) fund expenses.

Liquidity Penalties

Qualified Plans were designed to facilitate saving for later or post-working years. One of the key benefits is the deferral of taxes. That's the carrot. The stick is a penalty structure that is particularly punitive if an individual wants to take their money (yes it's their money…they earned it…who else's could it possibly be?) out prior to age 59½.

While there are a few limited exceptions, for the most part there is a 10% penalty on any money withdrawn prior to 59½.[16] You also are responsible for all of the regular taxes due on the amount of the withdrawal, which could very well jump you into a higher tax bracket. Additionally there is a 20% mandatory withholding on withdrawals so regardless of how much your actual tax liability is, you can only access 80 cents on the dollar.[17]

In 2010 alone, Americans paid $5.8 billion in penalties for early withdrawals from qualified plans, according to the IRS.[18] This is in addition to the regular taxes owed on these withdrawals.

So you want to retire before you are 59½? Or you want to help put your children through college or start a business, or maybe you lose your job and need the money just to eat? If your money is sitting in a 401(k)[19], tough luck…you should have been better prepared (unless you want to pay the 10% penalty).

Stopping the Qualified Insanity™

What if there was an alternative out there that allowed you to save for retirement while minimizing or eliminating those four Wealth Eroders in qualified plans? Is there a viable alternative to the Qualified Insanity™? There is, and it comes from an unlikely source: Cash Value Life Insurance.

Maybe it isn't that unlikely: insurers are some of the most financially secure companies in the world and have been effectively managing risk for centuries. In fact in the financial crisis of 2008-2009, insurance companies fared much better than other financial institutions.[20] The wealthy have been using cash value life insurance as a way of growing assets for years.[21]

This particular kind of life insurance is called Indexed Universal Life Insurance (IUL).[22] It addresses the four Wealth Eroders in Qualified Plans: Market Loss, Future Tax Increases, High Fees & Expenses, and Liquidity/Access, as well as offering one additional "Bonus Benefit" – if you die prematurely the plan self-completes and beneficiaries get a substantial death benefit.

[16] *Penalty Free 401(k), IRA Withdrawals*. http://www.bankrate.com/finance/retirement/penalty-free-401-k-ira-withdrawals-1.aspx.
[17] Here's a simple calculator from Wells Fargo. Remember to use the new tax bracket the additional income would put you in. https://www.wellsfargo.com/investing/retirement/tools/401k-early-withdrawal-calculator.
[18] Forbes, 1/15/2013. http://www.forbes.com/sites/janetnovack/2013/01/15/11-ways-to-tap-retirement-cash-early-without-a-10-penalty.
[19] Different types of plans have different provisions for penalty free withdrawals. Generally speaking, 401(k)s have more restrictions than IRAs.
[20] *Insurance and Financial Stability*. 2011. www.iaisweb.org/__temp/Insurance_and_financial_stability.pdf.
[21] http://www.businessweek.com/articles/2012-04-17/how-to-pay-no-taxes-10-strategies-used-by-the-rich.
[22] The discussion of IULs and Universal Life is very generalized and meant to introduce a concept. There are hundreds of different product offerings from various insurance carriers and their mechanics, features and designs will vary. Please carefully read all product literature on the specific product you are considering.

Universal Life Basics

There are a number of types of Universal Life Insurance (UL), also known as "flexible premium adjustable life insurance." At its core, UL is simply a very flexible policy chassis with premiums that can be increased or decreased depending on changing needs. The policy owner has the option of paying the minimum premium necessary to cover policy costs and insurance charges, or can pay a significantly higher premium and accumulate more cash value. As long as there is sufficient cash value in the policy, premiums may even be skipped.

When Universal Life is used as a retirement savings vehicle, the payments are set up in such a way as to maximize the amount of money going towards policy accumulation and minimizing the amount going to pay for a death benefit. There are certain parameters that must be met for the policy to be considered an insurance policy for income tax purposes.

What is Indexed Universal Life Insurance (IUL)?

Indexed universal life insurance works in a similar manner to traditional universal life insurance, with the exception that the indexed policy allows an individual to allocate excess premium payments to an account indirectly linked to the movements of an equity index (like the S&P 500®). Sometimes you will hear these policies referred to as "EIULs" or "Equity Indexed Universal Life."

While traditional universal life insurance pays a declared interest rate, IUL offers the potential to earn higher rates of interest similar to equity market-type returns. Premiums allocated to the indexed account earn interest based on the percentage change in the value of an underlying equity index. **Importantly, the amount of interest credited can never be negative.**

HOW CAN INSURANCE COMPANIES OFFER EQUITY-TYPE RETURNS WITHOUT ANY DOWNSIDE RISK TO THE POLICYHOLDER?

The insurance company is not directly investing any policy premiums in an equity index. Instead, the insurance company invests policy premiums in fixed interest investments (like investment grade bonds) and uses the earnings from those investments to purchase **call options**.

Call options provide the right, but not the obligation, to purchase a specific amount of a given index at a specified price within a specified period of time. If the equity index increases, the insurance company can exercise the right to purchase the index at the previously agreed upon price and then credit interest to the policyholder. If the equity index decreases, the company is not obligated to exercise any options and has incurred no cost other than the cost of the actual options. So if the equity index values decrease, the insurance company does not need to credit a negative interest to the policyholder's account.

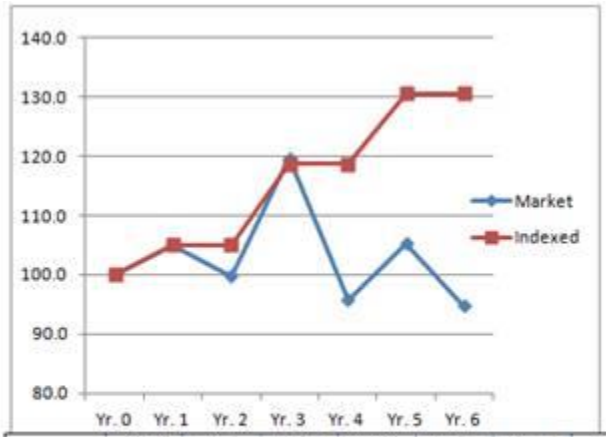
Policy Loans

All of this policy accumulation is great, but it is of no value for retirement savings purposes if it isn't accessible while you're alive. The IUL is specifically designed to allow regular access to policy value through loans on favorable terms. Since a loan is not considered income, it isn't taxed as income. In fact, it isn't taxed at all (do you pay taxes on your home, student, or car loans?). **At death, policy loans are simply paid out of the tax-free death benefit. You effectively never pay taxes on the money.**

So, how does IUL address the Qualified Insanity™ Wealth Eroders?

Market Losses -"Zero is your Hero"

We've already explored how indexing works: If an underlying index goes up, you get the corresponding interest credited to your account subject to whatever provisions your policy lays out. If the underlying index goes down, you get at worst zero or no interest credited to your account for the period.



	Yr. 0	Yr. 1	Yr. 2	Yr. 3	Yr. 4	Yr. 5	Yr. 6
Market	100.0	105.0	99.8	119.7	95.8	105.3	94.8
Indexed	100.0	105.0	105.0	118.7	118.7	130.5	130.5
	Delta	5%	-5%	20%	-20%	10%	-10%

Consider an example where the underlying index (or market) goes up 5%, down 5%, up 20%, down 20%, up 10% then down 10%. At the end of 6 years the underlying index would be down 5.5% (if it started at 100 it would then be 94.5).

Conversely, in an indexed strategy with a 13% cap, over the same time period it would: lock in a 5% gain after year 1, return zero (but not lose) in year 2, lock in 13% (capped) in year 3, return zero (but not lose) in year 4, lock in a 10% gain in year 5 and return zero (but not lose) in year 6. At the end of 6 years this strategy would return 30.5%.*(The example in the chart assumes no transaction costs, costs of insurance etc. It is meant only to demonstrate a concept.)*

Sure, if you thought the market was going to go up every year, or go up big most years and never lose big, this indexing strategy wouldn't make sense. But if you knew what the markets were going to do with any high level of confidence, you probably wouldn't be reading this.

Future Tax Obligations

This one is pretty simple: if structured correctly, there are no future taxes to be paid. In an IUL, the premiums or money going into the IUL are paid with after-tax dollars, so you will lose the tax deferral you get with the qualified plan. However you never have to pay taxes on any of the gains or accumulation.

Think of this as similar to the old farming parable: if you have a choice between paying taxes on the seed or the harvest which would you choose? This isn't a trick question. If you pay on the seed you'll end up paying much less. The after-tax contributions or premiums you pay are like the seed. They then get to grow and be harvested tax-free.

Fees & Expenses

You will pay fees and expenses on an IUL policy. In fact, one of the nice things about an IUL policy is in a pretty clear way each year you can see all of the fees and expenses you are paying in the policy. **Over the long haul these should be much lower than a 401(k) or other Qualified Plan with active investment management.** Your account is credited *based* on an index; you *aren't actually in* an index. You also aren't incurring the cost of active management. You do have the cost of insurance. If structured properly, that is relatively low (even for someone older or with some health conditions) and it should be more than offset by the savings in fees and expenses.

Liquidity/Access to Money

It's pretty simple: if you have money in the account you can access it. There are no penalties for withdrawing prior to 59½.[23] Like most insurance contracts, the costs are front loaded, so typically it is not advisable to try to access money in the first few years. Most policies are structured in such a way that you are paying into a policy for at least five years prior to accessing money. While you can access money early, **if you don't have at least a ten-year horizon, you should probably consider retirement savings options other than IUL.**

Additional Perks

Death Benefit: When you die, your beneficiary will get a death benefit. For most people, having a reasonable amount of life insurance is simply a responsible thing to have anyway. If you are younger and unmarried or have no children, odds are you will be in a different place in the future. This death benefit is permanent and less expensive now versus later. Even if you don't need insurance, if the contract is structured properly the other advantages of an IUL should more than offset the cost of insurance.

Don't underestimate the value of the death benefit: How much does someone with a 401(k) have if they plan to put a bunch of money into their account over the next few decades but get hit by a truck on the way home from work? With an IUL, if you die prematurely your savings plan self-completes via the death benefit and your loved ones will have income to replace yours.

No Limitations on Contributions: Practically speaking, there aren't any limits on contributions, although you must be able to qualify for life insurance. There are no restrictions on how much you can contribute because of your age or income, etc. If you want to accumulate more cash value you simply need to have a death benefit large enough for the contract to be considered insurance from a tax standpoint. A Roth IRA is another attractive option for retirement saving with after tax dollars and avoiding the perils of future increases in tax obligations. There are limitations with a Roth, including caps on contributions[24], and high-income individuals aren't eligible at all. You also have penalties for withdrawals prior to 59½.

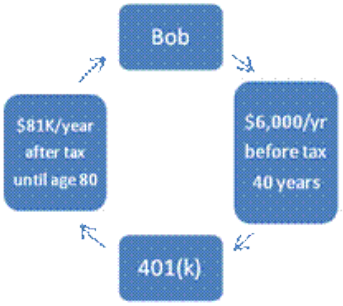
Other Applications: This discussion has focused on IUL as an alternative to a Qualified Plan. **The flexibility of IUL allows for a number of uses other than saving for retirement**. **IUL can be a very cost-efficient way of putting in place a life insurance policy that has a permanent death benefit.[25] It can also be a great way to transfer wealth.** That is, just because you have a bunch of money in the account available to access while you are alive doesn't mean you have to. If you don't use it while alive, all of that value is passed directly to your beneficiary at death, tax-free outside of probate.[26]

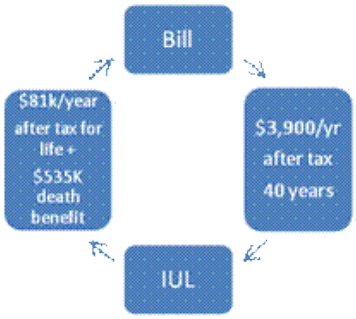
Case Studies

BOB & BILL: Bob and Bill are 25-year-old twin brothers. Bob takes the widely-travelled path and participates in a 401(k) through his employer. Bob puts $6000/year into the plan every year for 40 years. Assume he gets an average annual return of 7.5% reduced (very conservatively) by 1.0% for fees and expenses. At the end of 40 years he has an account value of $1,112,000. Bill decides to go the IUL route and puts $3900/year into an IUL[27] ($6000 less $2100 in taxes he pays in the current year, assumes a 35% tax rate). Bill's account also credited interest at 7.5%. The cost of

[23] No Tax penalties, your contract may be subject to surrender charges if still in the surrender period.
[24] For 2014, the limits are $5,500 or $6,500 for ages 50 and over.
[25] You likely want to use an IUL specially designed for a cost efficient death benefit. Ask your licensed professional for guidance.
[26] Consult your tax or legal advisor, as your unique circumstances may vary.
[27] Assumes standard non-tobacco rates, 7.5% annual rate of index crediting, 5% (guaranteed) participating loan, structured in a manner to optimize cash available for policy loans.

insurance and policy costs are included. At the end of 40 years Bill has only $758,000. Beginning at age 66, Bill is able to access $81,000/year for the rest of his life, tax-free as policy loans. Beginning at age 66, Bob is able to take distributions of $125,000 which he then pays $44,000 income tax (35%) on giving him the same effective cash flow after tax of $81,000. **The problem is Bob's money runs out at age 80.** Bill's money doesn't run out (ever) and if he were to die at age 90, Bill's beneficiaries would get a death benefit of $533,000 net of all policy loans. This is a conservative scenario only showing 1% in qualified plan fees and expenses and an effective tax rate that doesn't increase.



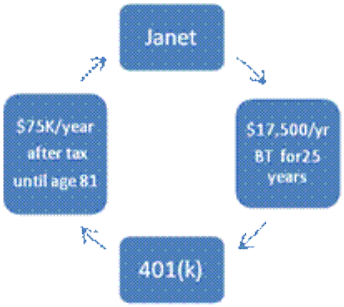


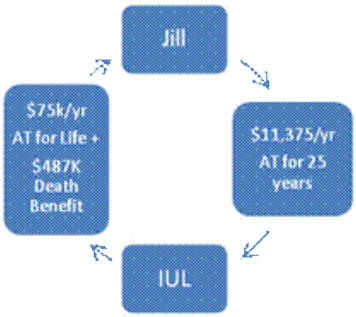
How does 401(k) Bob run out of money so quick? Several things are going on. First of all, the tax bite is quickly eating into his account while IUL Bill's distributions are tax-free. IUL Bill is also leveraging the power of a participating loan. He is being charged a contractually guaranteed interest rate of 5% on policy loans while his account is growing at 7.5%. He's still earning money on his money while he has use of it.

This hypothetical example makes a number of simplifying assumptions[28] to demonstrate a concept. **It is important to note that the rate of return in neither an IUL nor a 401(k) is guaranteed.** While an IUL will never lose money because the market goes down or the underlying crediting index goes down, it is dependent upon increases over time for interest to be credited to the account and substantial value to build. There is also no way of knowing with certainty what future tax rates will be. This case is being generous to the 401(k) and doesn't show them increasing. Also, don't forget that any and all guarantees in the IUL policy are dependent solely on the financial strength and claims-paying ability of the issuing insurance company.

JANET & JILL[29]: Janet & Jill are Bob & Bill's 40-year-old twin sisters. Janet also takes the widely-travelled path and participates in a 401(k) through her employer. Janet puts $17,500[30] into the plan every year for 25 years. Assume she gets an average annual return of 7.5% reduced (very conservatively) by 1.0% for fees and expenses. At the end of 25 years she has an account value of $1,098,000. Jill decides to go the IUL route and puts $11,375/year into an IUL ($17,500 less $6125 in taxes she pays in the current year, assumes a 35% tax rate). Jill's account is also credited interest at 7.5%. The cost of insurance and policy costs are included. At the end of 25 years Jill has $692,000. Beginning at age 66, Jill is able to access $75,000/year for the rest of her life, tax-free as policy loans. Beginning at age 66, Janet is able to take distributions of $116,000, on which she then pays $41,000 income tax (35%), giving her the same effective cash flow of $75,000 after tax. **The problem is Janet's money runs out at age 81.** Jill's money doesn't run out (ever) and if she were to die at age 90, Jill's beneficiaries would get a death benefit of $487,000 net of all policy loans. This is a conservative scenario only showing 1% in qualified plan fees and expenses and an effective tax rate that doesn't increase.

[28] Namely this assumes everything is flat or linear (in both the IUL and 401(k) scenarios): the same contributions every year, same distributions, same rates of return, etc. In real life these would vary up and down.
[29] Same design assumptions and notes as Bob & Bill except ages and contribution amounts.
[30] $17,500 is the maximum funding allowable in a 401(k) for 2014.





The same reasons Bob ran out of money so quickly also apply to Janet. **It is worth noting that if Jill thought she needed more than $75,000/year tax-free, she could simply get a bigger plan.** Here her premiums are modeled to be the after tax equivalent of Janet's who is "maxing out" her 401(k). Remember, there are no such limits on IULs.

Is there a catch? What do I do next?

There really isn't a catch. **The biggest negative to an IUL is that it is a long-term commitment (but then again so is participation in a Qualified Plan, but sadly most people don't think twice before they enroll).** In most cases you need to have a planning horizon of at least 10 years. There are a few "moving parts," and while on one hand the flexibility in the contract is a huge advantage for many, if you don't properly structure your contract or fail to fund it appropriately you can sub-optimize what you are able to get out of it. You want to work with an advisor that is trained and experienced in properly structuring IULs. Anyone with a life insurance license can legally market and sell you a policy; relatively speaking, few of them are experts on IUL or indexed products. Speaking with the licensed professional that gave you this document is a good next step. Likely they are a good resource for answering questions you may have, more completely explaining how an IUL works, and showing you how it may apply to your unique situation.

This copy of Qualified Insanity™ is provided courtesy of Dave Arlinghaus

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