Why Life Insurance Has to Be Part of Your Wealth-Building Plan

Find out why this expert says life insurance isn't a waste of money – it's leverage you need to gain financial freedom.

BY MARK J. KOHLER • FEB 14, 2018

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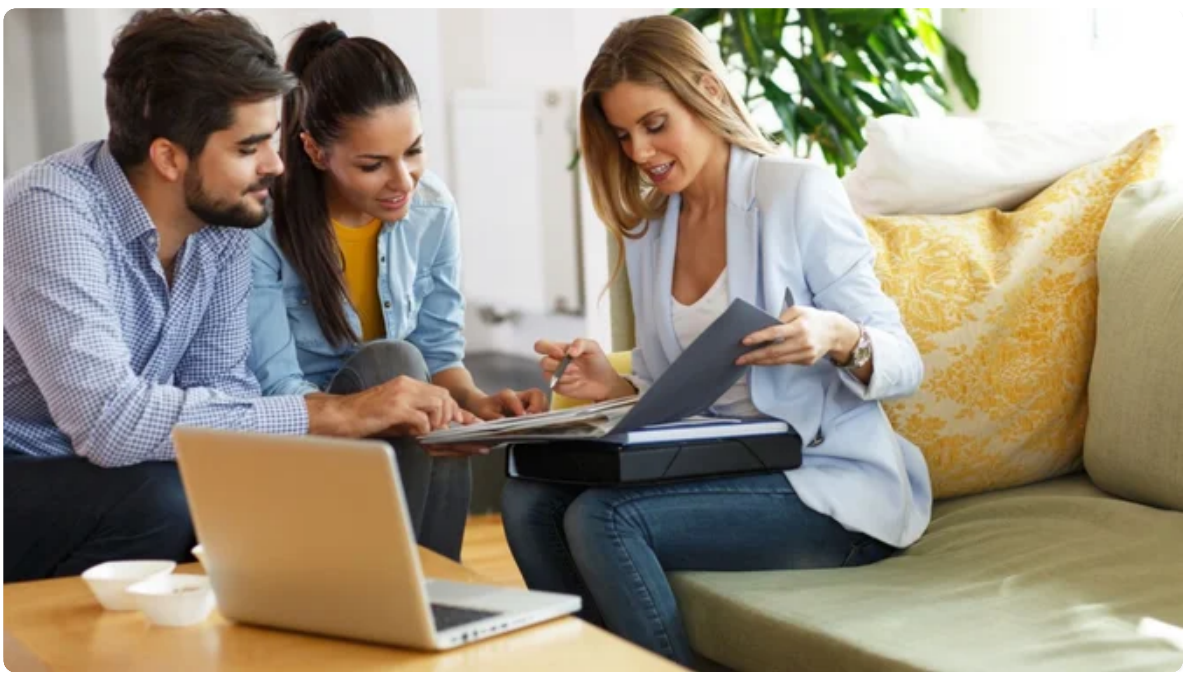

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The following excerpt is from [Mark J. Kohler] and Randall A. Luebke's book [The Business Owner's Guide to Financial Freedom]. Buy it now from [Amazon] | [Barnes & Noble] | [iTunes] | [IndieBound]

Every day, life insurance companies pay death benefits to the beneficiaries of their policies, providing them with needed and certainly welcome funds. In essence, life insurance provides leverage: You pay a relatively small amount of money to the insurance company in the form of a "premium," and the insurance company will provide a guaranteed payout of a relatively large amount of money upon the death of the insured.

While there are thousands of different life insurance plans available, they all fall into two categories: term and permanent insurance. Term, as the name implies, provides a benefit for a fixed period of time; 10 years, 20 years and so on. Permanent insurance is in place

Term insurance

This is the most efficient way to purchase life insurance. The premiums paid are calculated to accurately represent the risk of your dying based on your age, your health and so on.

The primary issue with term insurance is that it rarely delivers on its promise. That is, the large majority of term insurance policies, north of 90 percent, will never pay a death benefit. Why is that? Most people will either outlive the term of the policies or just stop paying the premiums. These facts contribute to the profitability of these products to the insurance companies, which enables them to keep the premium costs lower.

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Permanent insurance

This type of insurance can be expensive, but it doesn't have to be. Traditionally, when people think of permanent insurance, they think of "whole life." The benefit of whole life insurance is that everything's fixed and guaranteed -- the premiums are fixed, the death benefits, the cash values. The problem is that those guarantees are expensive because the insured is shifting all the risks. The investment risk, the risk of dying, inflation risks, every risk sits on the shoulders of the insurance company. While the insurance companies are used to this and they know how to live in that realm, they also know how to charge for it and they do.

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Universal life insurance

There's a third type of insurance, a hybrid model. Universal Life, or UL, is a term insurance plan that lives inside the shell of a permanent insurance policy. Designed correctly, a UL will provide the most efficient cost of benefits, which can also be guaranteed for your entire life. Designed improperly, the UL can become an even bigger waste of money than a term policy.

Living benefits

When most people think of life insurance, they think of dying and leaving a financial legacy for their loved ones. Modern insurance policies, however, contain many benefits you can enjoy while you're still alive. These "living benefits" range from tax-free accumulation of investment earnings to zero-interest loans. They can provide cash should you become seriously ill or if you need cash for a down payment on your home.

With living benefits so prevalent, more and more ways to utilize them have become popular. Among these is a strategy called "Bank on Yourself." The essence of this strategy is to take advantage of the tax-deferred growth on the earnings within life insurance policies by using tax-free loans to access the cash when needed. So you borrow the money from yourself instead of the bank, then pay yourself the interest and repay the loan you took from your policy.

Having your money grow tax-deferred and being able to access that tax-free is very powerful when you have a positive arbitrage -- that is, when you can borrow money at a lower rate and invest it at a higher rate.

Let's say you borrow $100,000 at an interest rate of two percent. Over the year, the $100,000 loan would cost you $2,000 in interest expense. Now, let's say you invested that $100,000 in a home and you flipped that home, netting you $104,000 and, after all expenses, making you a $4,000 profit. You might be tempted to say you made a four percent return on that investment, right? That would be wrong because you didn't invest $100,000. You borrowed it from someone else. You invested only $2,000 (what you paid out of your money in this deal). So in reality, you earned $4,000 on a $2,000 investment, or a 100 percent profit.

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But, what if the rate you earn on your investment is lower than the cost of borrowing? This is called "negative arbitrage." Using the same example, if you were to borrow $100,000 and net the same four percent, or $4,000 profit, but this time the cost to borrow the money was five percent or $5,000, now you have lost money on the deal.

Most modern life insurance contracts offer very favorable terms on their loans starting at two percent. Some insurance policies will allow you to borrow the money at 0 percent interest after you hold the contract for 10 or 20 years. Now you're like the bank, borrowing money for free.

The two percent or zero percent loans are written into the contract and guaranteed for life. They're referred to as a "spread loan" and a "wash loan," respectively. With these loans, you borrow your money out of the policy and can't earn any interest on it.

But, what if you could continue to earn interest on your money inside the insurance policy even after you borrowed it? That's how a participating loan works. The money you borrow is loaned to you at one rate, say five percent. However, the insurance company will continue to invest your money as though it was never taken.

In our opinion, life insurance policies designed properly with the right guarantees and terms can become a very valuable and beneficial financial planning tool.

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