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Below is a picture from the web-site http://dl.wealthpreservationinstitute.com/.

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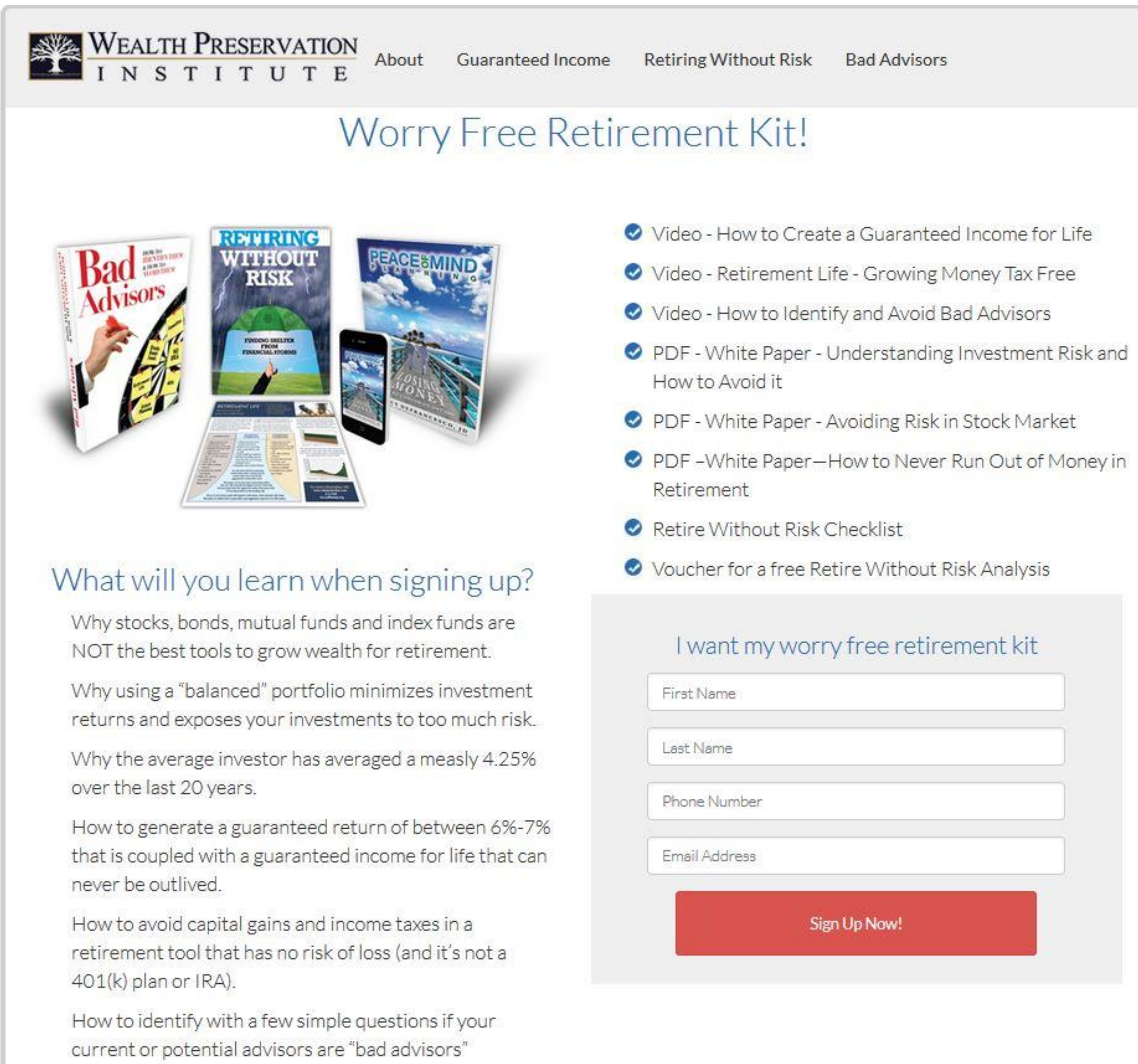

College Planning Using Cash Value Life Insurance

CAUTION:

College planning is a difficult topic for most parents who want to help their children pay for higher education. There are only so many options in the marketplace and unfortunately, most are not very good.

This paper was written to explain why using Cash Value Life (CVL) insurance is not a good tool when it comes to college planning for most parents.

Unfortunately, there are many life insurance agents who are pitching CVL or Single Premium Life (SPL) insurance as funding tools or tools to help children qualify for financial aid. While not covered in any detail in this paper, I wanted to briefly warn readers of funding what SPL insurance for college planning. “College planners” will pitch SPL not for college funding but to help students “qualify for financial aid.”

Why does SPL help qualify a student for aid? When calculating how much financial aid a student will receive, the parent’s assets are counted. If those assets are too high, that will hurt a student’s ability to receive aid. SPL, for many colleges, is not a “countable” asset in the aid formula. Therefore, there are many “college planners” telling clients to liquidate brokerage accounts or other assets (including 401(k)s and IRAs) to fund SPL. The theory being that once assets are transitioned into SPL, the balance sheet of the parents will be lower and the student will be more likely to qualify for aid. In short, this is not financially beneficial and should be avoided. If you would like more information on this issue, feel free to e-mail me at roccy@wealthpreservationinstitute.com

A quick review

College Funding using 529 Plans

Paying for a child or a grandchild’s college education has become increasingly difficult as the costs of college continue to increase. It really is unbelievable how much college costs today (and it increases every year).

Today, 529 plans seem to be the tool of choice to pre-fund and build a tax-favorable pool of money for college education. See the following Pros and Cons to 529 Plans:

Pros—

1) Once funded (after-tax), the money can **grow tax-free** and be **removed tax-free** for qualifying college education expenses.

2) If owned by the parent or grandparent, once funded correctly, the assets

(including growth) are out of their estate for estate tax purposes.

3) If owned by the parent or grandparent, if the child or grandchild does not go to college, the money can be used by the person funding the 529 Plan and would act like an IRA (with similar income taxes and penalties).

Cons—

1) If the child does not go to college, the growth on the money is taxable and subject to potential penalties when withdrawn/used by the parent/grandparent.

2) The money in a 529 Plan is **subject to loss due to market risk**.

3) 529 Plans are not "self-completing" should a parent or grandparent die prior to complete funding.

4) 529 Plans have funding limits. Funding is limited by the $13,000 annual gift tax exclusion (although they can be super-funded in year one by pouring in all of the first five year's worth of gifts all at once, $65,000).

Using Cash Value Life Insurance as an alternative funding vehicle for college expenses

Why would anyone use CVL insurance as a funding vehicle to pay for college education? Good question; and here are the simple and easy to understand reasons. (Initially, it will be assumed that the life insurance policy will be purchased on a child's parent.)

1) **Life insurance is a "self-completing" plan**. Let's assume Dad is the breadwinner in the family; and if he happens to die when a child is young without fully funding a 529 plan, there will be a significant shortfall when the child goes to college. With life insurance, if Dad dies, a sizable income tax-free death benefit will pay to the heirs who can choose to use that money for college education.

2) Money in a cash value policy will not only **grow tax-free** but it can be **removed tax-free** when used to pay for college expenses (policy loans).

3) If the child does NOT go to college, the policy will be a **terrific tax-favorable, wealth- building/retirement tool for the parent**. If you've read the education module on CVL insurance, you'll know why CVL insurance can be such a powerful wealth building tool.

4) After borrowing from the policy, it will still have cash in it and should grow for years to come. That means that money can be removed tax-free later on when the **parent is in retirement** (this is not possible with a 529 Plan).

5) Money in a CVL insurance policy is **not a countable asset** when a child goes to apply for financial aid for college (this is the case with most colleges but not all).

Based on the above positives of using CVL insurance policies, you'd think it is an easy decision to counsel a client to use a policy to fund for college education.

Unfortunately, that is not the case. As you will see with the following numbers, CVL insurance as a college-funding vehicle only works when a client not only funds the policy for future college expenses but also "overfunds" the policy with cash to be used as a supplemental retirement vehicle for the parents.

The following examples will clearly illustrate the problems with using CVL insurance as a college funding vehicle when it is not properly "overfunded," and some examples will illustrate how CVL insurance works very well as a funding vehicle.

Example 1

Assume your client is a 30-year-old (male) parent who has a 6-year old child. Assume the child will go to college at the age of 19 and will be there for five years. Assume Dad has $3,500 each year to pay towards a college funding vehicle and that he choose to fund that money each year into an EIUL policy every year from the child's age 6-18. Assume the policy runs at the MEC minimum death benefit and that the annual rate of return is 7.5%.

Initially assume that, when Dad takes out tax-free policy loans from the policy, he does so with "wash" loans.

How much could Dad remove from his life insurance policy from the child's age 19-23? **$12,330**.

How much could be removed each year from a 529 Plan where we assume a 1.2% mutual fund expense on the money in the 529 plan? **$16,125**.

Which one worked better? Hands down; it's the 529 plan.

What about using "variable loans" in the life policy?

I don't have space to explain how variable loans work in CVL policies. However, I will say that when illustrating a positive loan arbitrage in a CVL policy, it significantly increases the amount of money that can be borrowed from a policy for college funding or retirement. If you want to fully understand how variable loan work, e-mail me at roccy@wealthpresrevationinstitute.com and I'll e-mail you a PDF of my book Retiring Without Risk wherein I fully explain the power and danger of illustrating life policies using variable loans.

For this paper, what you need to know is that you can usually take significantly more cash out of the policy when you assume a *variable loan arbitrage* and that most policies are illustrated using a positive loan arbitrage of 1-3% (meaning the lending rate in the policy is 1-3% lower than the crediting rate (rate of return on cash in the policy)).

In the previous example, what if the policy had a **1% positive loan arbitrage**? How much could be removed from the life policy each year for college? **$12,696**.

What if the policy has a **2% positive loan arbitrage**? **$12,974**.

To many insurance agents who are used to illustrating variable loans in EIUL policies, the previous numbers won't make much sense. When you run a life insurance illustration at the MEC minimum death benefit (minimum death benefit before loans from a policy become taxable), you almost always are able to take out sizable amounts of cash and significantly more when you illustrate a 1-3% loan spread. Why in the previous example did the borrowing figures not significantly increase with a variable loan?

The answer is simple; while the illustration was run with the MEC minimum death benefit, it was not really "overfunded." Paying a $3,500 premium may sound like decent amount of money when funding a 529 plan for college funding, but that amount is not considered "overfunding" when trying to design a life insurance policy to work as a significant cash accumulator.

There are some positive things when funding a life policy for college funding. Using the current assumptions, the life insurance policy would slowly grow cash back in the policy after the amount assumed had been borrowed over the five-year college period and would have $64,000 of cash in it when Dad turns 70 with wash loans, $142,000 with a 1% loan spread and $209,000 if there is a 2% loan spread like the insurance companies believe will happen.

Additionally, the death benefit at age 70 would be $280,000. A client would neither have the ability to accumulate more cash to be used tax-free in retirement nor would he/she have an additional death benefit for the heirs should a 529 Plan be funded instead.

While the above positive sounds great, when you tell a client that they can fund $3,500 into a 529 Plan and remove **$16,125** vs. less than **$13,000** with a life insurance policy if both had a gross return of 7.5%, the client is going to usually opt for a 529 Plan.

Fixed Lending EIUL Policies

I also ran the numbers using my favorite **Retirement Life**™ EIUL policy that has a maximum lending rate of 5% (in other words it's not a variable loan rate). Unfortunately, the numbers did not improve much. The parent could borrow out $14,000 a year for the same time period).

Click here to learn about **Retirement Life**™ and why it can be a tremendous retirement vehicle (vs. college funding vehicle),

Other mitigating factors

Many clients who had money in 529 Plans in 2007-2008 really regretted the decision due to the fact that most 529 Plan account balances fell 40% or more over that 12-month period. This is a significant downside to funding 529 plans and one huge benefit to funding a non-variable CVL insurance policy (principal protection).

Example 2

For example 2, assume that, instead of insuring the life of the parent, the 6-year old's life is insured instead.

The same amount could be taken out of the 529 plan from the child's age 19-23 as funded at $3,500 a year: **$16,125**.

How much could be removed from the life insurance policy tax-free from ages 19-23 on the policy insuring the 6-year old child's life? **$15,339**.

As expected, the numbers are more than what could be removed from a life insurance policy on the Dad, but the numbers still fall a little short of what could be removed after-tax from a 529 Plan.

It is also important to understand that the examples are all run to maximize cash value which also minimizes commissions. The target premium on Example 2 is less than $1,000 (mainly because an increasing death benefit was used).

It is also important to understand that the illustration in this example and the others in this module are run using the "maximum" withdrawal amount from the life insurance policy when illustrating how much can be borrowed. In this example, there is only $1,097 in cash left in the policy at the end of the fifth borrowing year. This is NOT a conservative example. If the policy does not perform as illustrated or better in the next year and subsequent years, there will be a *call for premium*; or the policy will lapse. Keep in mind that this policy must stay in force for the rest of the child's life in order for the loans to not be taxable. That's a long time and one of the pitfalls of using CVL insurance as a funding vehicle on the life of the child.

I recommend that insurance agents give out "conservative" CVL illustrations. They should be run where there is a specific amount of cash left in the policies at the end of the borrowing phase. It is recommended that you leave 23% of the premiums paid as a cash value at the end of the borrowing phase. This should make sure that the policy will never lapse.

In my example, if you ran the illustration where the policy had $14,000 in cash surrender value left in the policy when the child turns 23, the child would be able to borrow out:

$12,532 at age 19
$12,908 at age 20
$13,296 at age 21
$13,694 at age 22
$14,105 at age 23

Total: $53,239

How much could be removed from the life insurance policy using max level income? $15,339 x 5 = **$76,695**.

How much could be removed from the 529 Plan (which also assumes a level income and that the stock market doesn't go in the tank shortly before or shortly after the child goes to college)? $16,125 x 5 = **$80,625**.

The point with the previous exercise as well as with all of these illustrations is to point out that funding life insurance for college planning sounds easy when it's really not. Just fund a life policy for X amount of years and show max borrowing. If you have the right variables manipulated the right way, you can make life insurance look like a very attractive option for college funding; however, the truth of the matter is that choosing to use life insurance as a college-funding vehicle is a very complex matter with many variables that must be discussed with and disclosed to clients so they can make an informed decision about how to best fund for their child's college expenses.

Example 3 (one that gets closer to making life insurance work better)

Now assume that instead of funding $3,500 every year from the child's age 6-18, fund $9,100 each year for five years (the same total funding amount as the earlier examples and assuming it's on the Dad's life). Assume the same 7.5% rate of return.

Note: This illustration was run on the parent, not the 6-year old child. When short funding on the child, the amount borrowed did not reach the level of what could be removed via borrowing from the 30-year old parent's policy (it was close but not quite as much).

How much could be removed from a 529 plan from ages 19-23? **$20,163**.

How much could be removed tax-free from the CVL policy? **$17,269**.

What if there is a 1% loan spread with the policy loans? **$19,175**.

What if there is a 2% loan spread with the policy loans? **$19,562** (getting closer).

Is there a minimum funding example using a reasonable rate of return where CVL works better than a 529 plan? Yes, make the child younger or the parent younger.

Example 4

Now assume the **child is just being born** (zero for calculation purposes). How does that help the numbers? Quite a bit because the life insurance policy has more time to accumulate cash and overcome initial up-front loads.

Note: This illustration was run on the parent, not the 1-year old child. This time the amount that could be borrowed from the child's policy was significantly lower than from the parent's policy.

How much could be removed tax-free from a 529 Plan using the same assumptions from Example 3)? **$29,051** each year from the child's ages 19-23.

How much could be removed tax-free from the CVL policy?

$32,075 from the life policy if there is a 2% spread on the loan.

$31,438 from the life policy if there is a 1% spread on the loan.

$30,784 from the life policy with wash loans of 7.5%.

With the "right" fact pattern, minimum funding of a life insurance policy can work as a better wealth accumulation tool for college funding. However, as you can see, the fact pattern is very narrow though.

Additionally, what happens if over time the stock market and the S&P 500 only average say 3.5%?

How much could be removed from a 529 plan? **$13,030**.

How much could be removed from the life insurance policy? **ZERO**.

This is a little misleading since there is still a cash surrender value in the policy of approximately $49,000 and the guaranteed cash value amount equals approximately $32,000. The illustration software simply does not allow borrowing from the policy due to insufficient cash.

The account value in the 529 plan is $60,000.

If advisors are going to pitch using CVL insurance as a college-funding vehicle, it would be nice if they gave their clients "full disclosure" which would include information about what happens when returns over time are low (not what were reasonably illustrated at inception).

“Overfunding” a CVL insurance policy for college planning (it works!)

The definition for this education module of “overfunding” is NOT just funding a policy at the MEC minimum death benefit but instead is defined as paying a sizable premium into the policy over a short period of time (10 or less years).

What’s sizable? In the college funding scenario, it’s funding the policy with not only the amount of money a client can budget for college planning but also for supplemental retirement planning/income for the parent(s).

Where can a parent find this other/extra money to fund into the life policy to overfund it?

Two main places for non-affluent clients (affluent clients simply have the money and need to choose to allocate it to the policy whereas non-affluent clients have to “find’ the money)

1) Reallocate money from a 401(k) plan

Many clients fund tax-deferred 401(k) plans for retirement savings. While this sounds like a good idea for most clients under the age of 50, funding CVL insurance after-tax will be a better, more tax favorable, and conservative way to grow wealth. I cover this in detail in my book Retiring Without Risk (if you would like a free copy of this book, simply e-mail roccy@wealthpreservationinstitute.com).

Therefore, instead of funding $5,000-$15,000 into a tax-deferred qualified plan, the client can allocate that money to funding a CVL insurance policy. This “additional” funding will make the life insurance policy work as a much better cash accumulating tool and should allow for plenty of money to be used for college funding and as a supplemental retirement plan.

2) Borrow money from a home

Many clients have as their only major asset the equity in their personal residence. Many times clients strip equity from their home at the time their children go to college because they neglected to properly plan. This can also be done when children are young and when using that money to “overfund” a CVL insurance policy, it will significantly increase the financial viability of using the policy both as a college-funding vehicle and a tax-favorable retirement vehicle.

Example 5

For this example, assume that the client is 40-years old instead of 30. Assume he has two children ages 13 and 10. Assume the client has not funded for his children's education and has sufficient income from all sources to "overfund" $50,000 a year into an EIUL policy every year (6) until the first child goes to college. The client is funding the policy not only to fund for college education but also to fund for his own retirement.

How did cash value work to help build wealth for college and to provide a tax-free retirement income stream for the parent? It worked really well.

Using a conservative 7% rate of return, the parent can remove $20,000 a year tax-free from the life policy when his first child starts college at age 19 and can remove $20,000 a year for that first child's first three years of school.

Then the parent could remove $40,000 tax-free for two years while his second child starts school and while the first child finishes up years 4-5 and then $20,000 a year each year for three years while the second child finishes up years 3-5.

$20,000 Years 1-3
$40,000 Years 4-5
$20,000 Years 6-7

It certainly makes sense that the client can pull out $200,000 to be used for his children's education since he paid premiums of $250,000.

The question is: How much can the client borrow from the policy **in retirement** from ages 66-85?

$66,108 tax-free every year for 20 years with wash loans
$91,127 tax-free every year for 20 years with a 1% variable loan spread
$180,715 tax-free every year for 20 years with a 2% variable loan spread

This is the POWER of using CVL insurance to fund for college planning *AND* retirement.

Summary on using life insurance for college funding.

Using CVL insurance from a pure financial standpoint is very difficult to justify for most average clients looking to minimum fund the policy when their goal is to only fund for college planning (unless you weigh the additional advantages CVL has over using 529 plans). Advantages such as:

-the life policy self-completes a plan for a parent who dies.

-locking in investment gains every year.

-allowing the client to use the funds tax-free for any other purpose.

-allowing the client to keep the policy in-force until he/she retires and potentially borrows more money out of the policy tax-free.

-the fact that CVL insurance is not a countable asset for financial aid calculations.

-also, **Retirement Life**™ can come with a long-term care rider to protect the client when in retirement.

However, when a client properly "overfunds" a CVL insurance policy not only for college funding, but *also for supplemental retirement planning*, it is very powerful and has a high probability of financial success in addition to the other advantages listed above.

Caution and full disclosure are the keys to giving client proper advice when it comes to using CVL insurance to fund for college planning. Unfortunately, full disclosure is rarely given (mainly because the advisors who pitch CVL as a college funding tool don't even understand why CVL doesn't work well).

College planning is a very powerful topic and uneducated advisors will use this topic to sell CVL and make themselves commission. The vast majority of the time such sales are not suitable (which is too bad for parents who don't know any better).

I hope that this paper helps readers understand that CVL is NOT a good college funding/planning tool for the masses. If you are using an advisor that advocates the use of CVL as a college funding/planning tool, tell him/her no thanks and then e-mail me at roccy@wealthpreservationinstititue.com and I'll refer you to an advisor I've trained who can give you advice that's in your best interest.

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-The Home Equity Acceleration Plan
-The Home Equity Management Guidebook
-Retiring Without Risk
-Peace of Mind Planning: Losing Money is No Longer An Option

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