Cash Value life insurance

We've all heard it: Cash Value life insurance is a horrible investment. However…

Are you ready for this? All those gurus and experts ARE RIGHT!

The problem, there's a "however" that needs to be added to that claim.

It should read like this: Cash Value life insurance is a horrible investment; however, if it's not used or designed for death protection and instead is designed to maximize the MEC (Modified Endowment Contract) rule, then there's no better place to park money.

Let's take a look at what was possible prior to 1986 when the government realized that the wealthy individuals had a tool that was too good of a tax shelter…got to love the government. Prior to 1986 NO ONE talked bad about life insurance. Why? Because you could put as *much as you wanted, no limits,* into a policy and the insurance company would underwrite you for a small amount.

For example: someone with a million dollars could put it into an insurance policy and the insurance company would underwrite them for maybe $100,000 in death benefit. Why would the individual do this? For many reasons: All the money in the policy was safe from lawsuits, litigation, and even IRS liens. The money was totally liquid and they had available what they put in. Let me say that again: this money was *completely* liquid and could be used at anytime with NO qualification necessary and NO IRS involvement. The money also had *guaranteed* growth.

Real life example: the Denver Business Journal in November of 1999 produced what they called "The Century Book". This special edition provided a 100 year history of Denver and highlighted something or someone for each year of the century. When you come to the year 1929 the event covered was of course the Great Crash. Also within that article was the story of one of Denver's most wealthy individuals and at the time Denver's best market player, Claude Boettcher. The article says this:

"When he returned (he was traveling in the Soviet Union when the market crashed), he fired the messenger who brought him news of his financial ruin. He had the courage to wait for stocks to drop more before he borrowed $2 million for his insurance policy and bought stocks and banks – the reason he is still known to history."

How much death benefit do you think $2,000,000 in cash value would have to have? Back then, very little. Notice, when the market crashed he didn't lose his cash value. It's guaranteed. It can't be lost. He was "financially ruined" but did that affect his ability to access his capital? Nope. What is the one factor that saved him financially? Having access to capital. If this tool was not in his portfolio then Claude would have been just another story of riches to rags. But still to this day his wealth lives on here in Denver. Now if he was Denver's best market player why in the world did he have so much in cash value life insurance? He was obviously one smart man.

In 1986, the government decided that it was not fair that the wealthy had such a great tax shelter tool and decided to create what is called the Modified Endowment Contract. Basically, this rule added the risk to the insurance company by creating a minimum death benefit for the premium being paid to fund the policy. If a policy owner goes over this MEC line then the majority of all tax advantages are wiped out. The policy becomes a qualified plan with the IRS all over it…forever. This new MEC rule limits what I can do with my own money…thanks Big Brother.

Let's get back to the original MYTH. Virtually all gurus and experts say that Cash Value life insurance is a bad investment. Let's first prove they're right before we illustrate the proper use of the MEC line.

If I had a healthy, 30 year old client who was willing to fund a policy for $25,000 per year, how much insurance do you think that would buy? Probably around $2,500,000 in death benefit. Why would this be a bad choice? For the exact reason Dave Ramsey and Suze Orman say: your cash value sucks. Now Dave says you have no cash value for three years…even with this type of policy he's wrong; however, it would take 12 years of paying $25,000 each year before you'd have available in cash value what you put in. Not a good option. If you needed $2.5 million in death protection then buy term and invest the rest.

Here's the "however". However, if the policy is NOT designed to maximize the death benefit and "dance" on the MEC line then what do we have?

Same example: this client is willing to fund a policy for $25,000 per year but we use it to purchase the LEAST amount of death benefit in order to have the most cash value available. The death benefit is only $900,000 and he has over $17,000 available DAY ONE. When he makes his year three payment of $25,000 his cash value grows by $29,000…already getting back more than he put in. At the end of year four when year five's premium is paid, his total cash value exceeds what he has paid into the policy…NOT twelve years. Let me ask you this: if you save for five years to buy a car by using a money market at your bank (which is what Dave Ramsey recommends), how much would have in the account? What you put in right? Plus a very small amount of interest; however, the IRS takes their share of that every year. If Dave Ramsey recommends this type of account for purchasing items how is a policy designed in this matter a bad thing? Keep in mind, the IRS doesn't get their share. Shoot, you even have a growing death benefit just in case…at year five the death benefit is over $1.3 million.

Insurance people think we're the stupidest insurance agents around. Why? Because we don't get paid on the cash portion of the policy. The commissions would be incredible if we did the first example but we aren't here to sell expensive death benefit policies we're here to teach individuals how to bank. Our commissions are significantly reduced. Why would an insurance agent turn someone down this path when they can attempt to sell a huge policy and make a ton of money? We don't consider ourselves insurance agents, we're bankers.

So why would we want to fund a policy like this? My next post will be how to USE these funds to redirect debt or purchase vehicles, equipment, etc. Over time, if you implement this concept, you will NEVER pay another dollar in interest to another entity, you will NEVER need to finance with a bank, and you will NEVER lose a dime.

Cash Value life insurance is a horrible investment; however, if it's not used or designed for death protection and instead is designed to maximize the MEC (Modified Endowment Contract) line, then there's no better place to park money. You get back everything you put in, there is no risk of principle loss, there's a guaranteed return plus a tax-free dividend, compounding growth, gains tax-deferred but can be used later in life tax-free, no government involvement (they already ruled on all this), creates an immediate tax-free estate, and most importantly, it's liquid and you have complete use and control of the money (read that one again – what other tool, other than a bank account, can you claim this).

You can have everything you need and anything you want. Don't use the bank, be the "Bank". Do what the wealthy have done for ages.