Why Indexed Universal Life Insurance Can Be a Good Retirement Investment

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NEW YORK (MainStreet) — Indexed universal life insurance policies can serve as another investment option in your retirement portfolio and allow you to accumulate cash on a tax-deferred basis.

The funds you allocate for an indexed universal life policy (or IUL) allow you to direct the premium into one or more index allocation options such as the S&P 500 index, said Allie Miller, CEO of AMZ Financial Insurance Services in Urbandale, Iowa. The insurance company tracks the index performance and uses a crediting method to calculate your indexed interest and the interest is credited to your cash value.

If the index declines, the crediting formula allows you to avoid the loss and earn zero interest in down years, he said. When the index rises, the insurance carrier credits those positive returns based on its formula since there is often a maximum crediting rate that can be earned.

"The most unique feature is that an indexed universal life policy eliminates the market volatility, yet provides the mechanism to earn competitive interest rates," Miller said. "Traditional market-based vehicles have been on a roller coaster ride since 2000, and consumers continually search for ways to minimize their market exposure."

The advantage of owning an indexed universal life policy is that in a permanent life insurance policy's cash value, performance is tied to the performance of certain index unlike a variable universal life, said Andrew Carrillo, a certified financial planner in Miami and president of Barnett Capital Insurance, which specializes in life insurance and annuities.

"The principal of your cash value in the indexed universal life is never at risk," he said.

While there are different methods to calculating the interest you receive, the maximum amount of interest is often 14.5%, Carrillo said. One of the most common indexes chosen is the S&P 500 index, so if the index increases by 10% in the first year, then your account will be credited 10%. If the S&P 500 increases by 20%, you will receive 14.5%. However, if the index dipped by 50%, the policy will receive no interest, but doesn't lose any money.

"The ability to capture market upside with no downside is very attractive," he said. "It's important to note dividends are not included."

An indexed universal life policy is a good asset for investors ranging from 18 to 50 years old, because the principal amount of the policy can never decline, Carrillo said.

“If an indexed universal life is properly funded, it can create a very unique retirement asset,” he said. “Investors with good cash flow and in high tax brackets benefit the most from the cash accumulation potential due to the tax benefits.”

A standard universal life policy earns a fixed rate of 3% to 5% currently, depending on the carrier, while indexed universal life policies have historical average returns over 8% annually, Carrillo said.

“Certain insurance companies have no cap options with the indexed universal life as well and the principal protection still remains,” he said.

The costs of an indexed universal life policy consist of two sections. If you pay a monthly premium of $400 per month, $100 per month would be allocated for the cost of insurance while $300 goes into the index.

Overfunding your policy can be more beneficial, Carrillo said. If you increase your premium to $1,000 each month, the cost of the insurance remains at $100 per month and $900 goes into cash value. If the index achieves a 14% rate of return, then your $900 increases by $120 and pays for your insurance.

Another advantage of an indexed universal life policy is that you can borrow money from it without a tax penalty, said Miller.

“When an emergency arises, money can be withdrawn or loaned from the life insurance policy without a tax penalty,” he said. “This can be a significant benefit over other accounts such as a 401(k) or IRA, which don’t offer similar tax benefits. The tax-advantaged income from an IUL policy can also be used to help compliment retirement income.”

The only difference between an indexed universal life policy and other permanent life insurance policies is the way interest is credited to the client’s policy value, said Ray Caucci, senior vice president of product management, underwriting and advanced sales at Penn Mutual Life Insurance Company in Horsham, Penn.

Indexed universal life policies remain popular among people mid-career toward retirement, because those investors “put in large premiums to build up cash value while they are in their working years,” he said.

The policy still has a death benefit, but the policy holder can use that accumulated cash value for things he needs before reaching retirement, whether it is to pay for higher education for themselves or a child or the care of an elderly parent.

“If the policy holder takes a loan out against their policy and pays it back in full later, the entire death benefit is restored,” said Caucci. “Families and small business owners purchase indexed universal life most often because they are generally people who are looking to secure a death benefit to protect loved ones, but also see the significance in being able to access the cash value.”

--*Written by Ellen Chang for MainStreet*