Nationwide®
is on your side

The Advanced Consulting Group

White paper

Using VUL and IUL accumulation life insurance for supplemental income and other income needs

Shawn Britt, CLU®, ChFC
Director, Long-term Care Initiatives, Advanced Consulting Group

---

Prior to the stock market crash of 2001, variable universal life (VUL) insurance was a popular tool in creating a strategy for supplemental income. Whether to enhance income for later in life or help pay for future expenses such as college or weddings, VUL saw great popularity due to its tax advantages and flexibility. VUL also had the advantage of unlimited growth potential, but with that also came the risk of loss that could cause a policy to lapse. The after effects of the downturn in the stock market in the early 2000's left VUL in an unpopular position with clients wanting more guarantees and safety nets. Today, for clients with a life insurance need and adequate risk tolerance, VUL may well be worth another look, especially in light of some of the additional benefit riders that can be added to a VUL contract.

In addition, there is another cash accumulation life insurance policy to consider for clients who want some exposure to the market with less risk and without the downside of market loss — indexed universal life (IUL). With this cash accumulation policy, the cash value is placed in indexes associated with the policy. Generally, the indexes cannot earn less than 0%, but there is also a cap on how much interest can be credited (such as 12%) based on index performance (such as the S&P 5000). This more conservative policy still allows for nice accumulation potential while limiting potential cash value loss each year to the amount associated with policy charges should the policy see 0% growth in the indexes.

Accumulation life insurance in today's market

An insurance-based income (IBI) solution is designed around a variable universal life insurance policy (VUL) or indexed universal life policy (IUL) that provides a death benefit to the insured's beneficiaries, but at the same time, provides cash value which enjoys tax-deferred treatment and the potential to take tax free income (as long as the policy stays in force). Under the current Internal Revenue Code, cash value within a life insurance policy accrues tax-deferred, while the income from a cash value life insurance policy can be accessed income tax-free (in most situations) through the process of taking tax free withdrawals up to the cost basis in the policy, then taking tax free loans.

While an IBI solution is most often used to create supplemental retirement savings, keep in mind that there are no restrictions as to when withdrawals and loans can be taken, so it can also provide funds for college expenses, wedding costs, and other financial obligations. Since the insured owns the policy, he or she has total control as to how the money comes out of the policy, when it comes out of the policy, and what the income is used for.

An IBI solution may be a good choice for high income individuals who have maximized their qualified plans and wish to save more money in a tax deferred manner, or who want tax deferred savings without the restrictions of a qualified plan. It may also make sense for business owners who do not offer qualified plans and wish to save for themselves, or even provide non-qualified benefits for employees with little complication through an executive bonus arrangement.

Let’s review the advantages of using cash value life insurance such as VUL or IUL:

- Tax deferred growth potential
- Tax free income — as long as the policy remains in force and is not a modified endowment contract (MEC)
- Income tax free death benefit to the beneficiary
- No contribution limitations (except that which keeps the policy a non-MEC and is consistent with the underwriting offer)
- No penalty for taking income prior to age 59 ½. Income can be used for any financial need or purpose the client has at any time he chooses
- Sub-account reallocation opportunities without charge, subject to any short-term trading fee that may apply; please consult the prospectus for complete information.

For the business owner, VUL or IUL offers additional advantages:

- Leverage a C-Corp tax rate against a personal tax rate with an executive bonus arrangement for the business owner.
- For owners of pass through entities, an IBI solution can be funded with dividends or capital distributions.
- Use VUL or IUL in an executive bonus arrangement for employees you wish to reward and retain. A restricted executive bonus agreement (REBA) can be added to supply “golden handcuffs”.
- VUL or IUL can also be used for deferred compensation and split dollar strategies.

Why consider Nationwide’s VUL and IUL?

Using Nationwide’s VUL and IUL as part of a supplemental retirement income strategy or other income needs offers advantages that may be new to the client. Nationwide’s comprehensive contract management program has four innovative features to help provide a new level of service to our VUL and IUL policy owners:

- **Death Benefit Guarantees — EDBG Rider (Extended Death Benefit Guarantee) or Extended NLG Rider (Extended No Lapse Guarantee)** — these riders are for the client who is not as risk tolerant but still want market exposure through sub-accounts or indexes - and would like to guarantee their death benefit will stay in force (subject to the claims paying ability of the issuing insurance company).
- **Automated Income Monitor (AIM)** — Allows flexibility of income distribution as well as tools to re-examine a client’s objectives on an annual basis.
- **Over Loan Protection Rider** — Helps protect heavily loaned policies from lapsing.
- **Long-Term Care (LTC) Rider** — Allows access to the death benefit — while living — to help fund long-term care needs.

Let’s take a closer look at these features and riders.

Extended No Lapse Guarantee Rider
Clients wanting cash value growth potential along with death benefit guarantees now have the option to add a death benefit guarantee rider, available with variable life and indexed universal life insurance. While some policies in the past had limited death benefit guarantees, some new VUL and IUL products today not only include a limited death benefit guarantee but offer a rider at an additional cost that will allow the policy owner to dial in death benefit guarantees that can extend for the client’s entire lifetime. Guaranteed periods can be for a lesser number of years as the policy allows. Keep in mind, these riders may limit some of the sub-accounts available to the policy owner by removing the most aggressive funds from the policy owner’s fund choices. In addition, all guarantees are subject to the claims-paying ability of the issuer, and do not apply to variable underlying investment options.

Automated income monitor (AIM)
When the client is ready to take income from his or her VUL or IUL policy, the automated income monitor (AIM) system will allow the client to set up an income stream strategy of his or her own choosing by submitting paper work only one time! In addition, the client and their advisor will receive annual re-proposals that will illustrate whether the income taken is keeping pace with the performance of the policy. The client then has the option to change the amount of income they are taking or the length of time over which it is received, if desired.

Over loan protection rider
As the client continues to take income and the policy becomes heavily loaned, the over loan protection rider will monitor the cash value. Once the client is aged 75 or older, should policy indebtedness become more than a certain percentage of the policy's cash value — hitting the "trigger point " — the client will be contacted and can choose to invoke the over loan protection rider. This will place the policy in a guaranteed paid up status, protect the policy from lapse and help protect the client from the potential of incurring a large taxable event. There is only a cost if the rider actually needs to be invoked. The client must meet the rider requirements to invoke the rider, and the trigger point will differ based on the age of the client.

Long-term care rider
Completing the advantages of Nationwide's VUL and IUL suite of products is a long-term care rider that can also be added to the policy for an additional charge. Once the insured meets the LTC rider requirements, which include being certified as having cognitive impairment or the inability to perform two activities of daily living (ADLs) for at least 90 days, a cash indemnity monthly LTC benefit is paid as an acceleration of the death benefit. Life insurance needs and circumstances may change as we age. The LTC rider can help provide clients coverage for potential LTC needs through their life insurance policy when other obligations that life insurance covered in the past are no longer of concern. In addition, if LTC benefits are never needed or not fully exhausted, the remaining amount is paid to the beneficiaries as a federal income tax free death benefit.

In summary

If you have clients that could potentially benefit from accumulation of cash value in a life insurance policy for the purposes of supplemental income in the future, it may be time to give VUL another look or consider IUL for more conservative clients. Nationwide's newest VUL and IUL products can provide the death benefit protection a client is looking for as well as financial benefits during their lifetime in a tax efficient manner. With the addition of new features and riders, Nationwide can help keep your client's policy protected from the possible taxable consequences of distributions through our comprehensive policy management programs, provide a death benefit guarantee if desired, and provide transition from a policy needed for family protection to LTC coverage that may eventually be needed.

Nationwide®

FOR BROKER/DEALER USE ONLY — NOT FOR USE WITH THE PUBLIC

This material is not a recommendation to buy, sell, hold or roll over any asset, adopt an investment strategy, retain a specific investment manager or use a particular account type. It does not take into account the specific investment objectives, tax and financial condition or particular needs of any specific person. Investors should work with their financial professional to discuss their specific situation.

Federal income tax laws are complex and subject to change. The information in this memorandum is based on current interpretations of the law and is not guaranteed. Neither Nationwide, nor its employees, its agents, brokers or registered representatives gives legal or tax advice.

Nationwide, the Nationwide N and Eagle and Nationwide is on your side are service marks of Nationwide Mutual Insurance Company. © 2019 Nationwide

NFM-5187AO.9 (10/19)