

Are You Selling MFL?



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Here's a fact that many have forgotten. When universal life first hit the market it was sold primarily as a retirement program. It was the first maximum funded life (MFL) plan. In extreme cases a client could get a plan with \$10,000 at risk, paying an unlimited premium payment, or he could pay \$1 million in premium with a death benefit of \$1,010,000. *Not good for life protection, but boy did it build the cash values!*

It did not take long for the government to close this loophole. The first try was the Deficit Reduction Act of 1984 (DEFRA)—but all that did was promote single premium life. So next came the Technical and Miscellaneous Revenue Act of 1988 (TAMRA) and modified endowment contracts (MECs), which put limits on how much could be contributed during the first seven years and still get the full tax benefits from a life insurance policy. If the amount was exceeded, a policy was like an annuity with a tax-preferred death benefit. However, staying within the MEC limits, a policy could have it all—tax-deferred growth, tax-free withdrawal up to basis with tax-free loans thereafter, and income tax-free death benefits. *The home run of tax-favored retirement funding!*

What types of universal life are being sold most today? Lifetime guaranteed death benefits—the highest possible death benefit for the lowest possible premium, the opposite of MFL.

Let's Go Back to the Future with MFL

Maximum non-MEC funded life insurance—or the MFL strategy—should be considered as a useful part of a comprehensive retirement program. It gives your clients

tax-deferred growth, tax-free access to their money (within limits), plus income tax-free death benefits that may be much higher than they could save for on their own.

The key to taking full advantage of this strategy is to pay the highest possible non-MEC premium using the lowest possible death benefit. This combination takes full advantage of the government-provided tax advantages for life insurance.

By the way, because of the way DEFRA guideline premiums take full advantage of the maximum non-MEC premium, the insured will have an increasing death benefit. So, while at the start the insured is paying the highest premium for the lowest death benefit, over time the death benefit grows. Thus, by the time the insured dies, the death benefit may be greater than a plan with the lowest premium for the highest death benefit.

How Does an MFL Plan Stack Up?

Table 1 (on page 22) illustrates how MFL plans compare to other common tax-deferred programs allowed under the tax code. When comparing MFLs with the three most common retirement programs—qualified plans, IRAs, TSAs, pension plans and 401(k)s; Roth IRAs; and non-qualified annuities—only the qualified plans get a current deduction. All of them avoid current taxes on plan asset earnings. However, only MFLs—via withdrawals and loans—and Roth IRAs avoid income taxes when cash is taken out or upon death. With the other plans, the IRS is just waiting to collect their taxes.

Another advantage of MFLs is that they pay a death benefit which, in most cases, is

Table 1
MFL Versus Other Tax-Advantaged Funding Vehicles

	Qualified Plans IRA, TSA, 401(k)	Roth IRA	Non-Qualified Annuities	MFL (UL)
Current Tax	Pre-Tax or Deductible	No Deduction	No Deduction	No Deduction
Earnings Tax	No	No	No	No
Withdrawal Tax	Yes	No	Yes, Gain Only	No
Death Benefit Tax	Yes, Spouse No	No	Yes, Gain Only	No
Amount at Death	Account Value	Account Value	Account Value	Death Benefit
Limits on Amounts and Timing	Yes	Yes	No	No
Effect on Social Security Benefit	May Make Taxable	None	May Make Taxable	None

greater than the premiums plus earnings paid into the life policy.

How involved does the government get? Only non-qualified annuities and MFLs have no funding limits. Remember, though, that MFLs do have the MEC rules that must be followed. Also, if your clients have a heavily funded qualified plan or non-qualified annuities, they can expect to pay taxes on their Social Security benefits. With Roth IRAs that problem can be avoided, but the funding limits are fairly low. *Only MFLs do not affect Social Security benefits and have almost unlimited premium funding.*

If the goal of saving for retirement is the maximum after-tax income in retirement, then MFLs may help your clients get there.

Let's recap the advantages of an MFL insurance plan. It's life insurance, so your clients get pre- and post-retirement death benefits with typically no income tax on the growth in cash value every year. Money can be taken out of the plan by loans and withdrawals without paying current income taxes, and the policyowner will never pay income taxes as long as the policy ends in death. This cash flow after retirement will not affect Social Security benefits. There are no rules that say money must be withdrawn

from the policy; policyowners can elect not to withdraw funds from the policy so that beneficiaries can receive the death benefit without income tax. Remember, since it's an increasing death benefit, the cash values are not lost at death. There are no government rules or annual reporting, other than the premium and death benefit MEC guidelines that make it life insurance.

MFLs Are About Current Protection and Retirement Funding

The MFL design of the lowest possible death benefit may in some cases be a disadvantage. Perhaps your client has a need for a higher death benefit, especially in the near term. Remember, the lower starting death benefit will grow over time because it's an increasing death benefit; however, that growing higher death benefit will "eat" into the cash-value growth, due to higher insurance charges. Thus, the long term cash values will be about 5 to 10 percent lower. Yet the over-funding should still produce good cash-value growth.

Since a UL is used in the MFL, increasing and then decreasing the face amount IS possible in order to lower the cost of insurance in the later years. But it's complex and could be affected by estate tax guidelines. Your clients will want to own

their policy to have access to its cash values; yet this could make the death benefit subject to possible estate taxes. Therefore, a complete estate plan should be done before your clients enter into an MFL arrangement.

What Policies Can Be Used in an MFL?

Any universal life policy can be set up as an MFL—even a second-to-die policy may be used in this market. So you can use any plan you are currently marketing, which includes fixed interest, variable or indexed universal life policies. I lean toward an indexed universal life policy because of the added power of market growth.

An indexed UL policy offers a crediting rate tied to the growth of an index such as the S&P 500 (using either capitalization or participation rates—or both—that are subject to change) with the security of a minimum interest guarantee. Once interest is credited it cannot be lost due to future market changes. This type of policy offers more upside potential than fixed UL without the downside risk of variable UL.

Why Does MFL Work?

First, the power of compound interest. Albert Einstein once said that compound interest was one of the most powerful forces in the universe.

Second, Congress long ago gave life insurance a preferred tax status. It did so to encourage consumers to protect their families and themselves—*still a desirable goal.* Although the government has toyed with the status a little—DEFRA and MEC for example—the preferred status has wisely been left in place, allowing cash value to build tax-deferred, grow through the power of compound interest and be passed on income tax-free in the form of a death benefit.

By implementing an MFL insurance policy your clients are taking both of these forces to their maximum. It is every American taxpayer's option to consider an MFL policy as part of their overall retirement plan. As an insurance professional you are best positioned to help them. You need to talk to your clients today about MFL. 🌐