

From the author of  
*Living Outside The Cubicle* and *The Icon Effect*

# ouch.

*How My Financial Advisor  
Lost Me \$930,000 In Three Years*



*And How To Prevent This  
From Happening To You*

**DARREN SUGIYAMA**

# Ouch: How My Financial Advisor Lost Me \$930,000 In Three Years

And How You Can Prevent This From Happening To You

*Darren Sugiyama*

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In addition, this book and the contents within are not be to used to convince anyone to buy a life insurance policy, or to suggest that any other financial investment should be replaced with a life insurance policy. Every decision regarding such topics should be discussed with a licensed insurance professional that you trust.

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## Foreword

Tons of Americans, toward the end of their lives, say things like, “*I wish I would’ve...*” or “*I should’ve...*” especially when it comes to retirement planning, or more specifically, the lack thereof.

Since I was a little kid, for whatever reason, the fear of being *elderly and broke* has always scared me to death, and so this issue of *retirement planning* has been at the forefront of my mind for years.

Though I was born with the entrepreneur gene in my DNA, I officially became an entrepreneur in my mid-20’s.

By my mid-30’s, I had built a successful company, and like so many other entrepreneurs that are obsessively focused on building their empire, I had limited time to do my own research and due diligence regarding my own retirement planning.

So what did I do?

I did what most busy, obsessive entrepreneurs do that don’t have the time to do their own research.

I hired a *Financial Advisor* to do it for me.

I *trusted* him.

Big mistake.

His bad advice lost me over \$930,000.

I ended up sinking hundreds of thousands of dollars into a bunch of ill-advised life insurance policies under his direction. The total premium on these policies totaled over \$200,000 per year, which I did for three years. Do the math.

I didn’t understand what I bought or how they worked.

Like I said, I just *trusted* him.

He constructed a very elaborate strategy that was supposed to save me a substantial amount of money in taxes while at the same time setting up a tax-free retirement plan for me and my family.

It all *sounded* good, despite my lack of understanding of how it actually worked.

Again he was my *Financial Advisor*, so I trusted him.

But after three years of doing this, I thought it might be prudent to get a second opinion on what this *Financial Advisor* was having me do.

I hired a tax attorney to do an internal audit, hoping he could tell me whether or not this plan was a good thing.

After about a week of him analyzing all my files, documents, life insurance policies and contracts, he informed me that the entire program was out of compliance.

He informed me that I had to unwind the entire program, and on top of that, the retirement account balance in all of my life insurance policies combined was ZERO.

I immediately called the CPA firm that did both my business and personal tax returns and informed them. It took them about two weeks to unwind everything and when they came back with the numbers, I got another giant knot in my stomach.

They told me I now owed the IRS and the State of California over \$330,000 in back-taxes, penalties and interest.

And on top of that, I also incurred attorney fees and CPA fees to dismantle this disaster.

After \$600,000 in wasted insurance premiums and \$330,000 in back-taxes, penalties and interest, the initial hard-dollar losses totaled \$930,000. This doesn't even include the CPA fees and attorney fees I paid to set up this program, nor the fees incurred to dismantle this program

Add up all of these expenses and the total fiasco cost me well over \$1 million, not to mention the time and emotional aggravation it caused me.

After this frustrating and financially devastating experience I thought to myself, *"If this happened to me, there must be thousands of other successful business owners out there that are being taken advantage of too... and I'll bet they don't even know it."*

I started asking my successful friends who owned businesses if they understood how their life insurance policies worked, and sure enough, they were just like me.

They didn't have a clue.

Then I started asking them about their retirement plans and their investment portfolios, and again, they were absolutely clueless. They didn't understand the rationale nor the philosophy that was used to construct their portfolios.

So why were all of my successful friends so clueless when it came to their investment portfolios and retirement plans?

It was obvious.

They were just like me.

They were so busy running their companies, they didn't have time to learn the details regarding their investment strategy, which is why they hired a *Financial Advisor* in the first place.

The result of my financial ignorance when it came to my own financial plan made me furious.

As a client, I was getting bad advice and I didn't even know it... and neither did my successful friends.

Once I uncovered this dirty little secret, I became obsessed with learning everything I could about investments, life insurance, tax law and retirement planning.

Then I started talking to my clients about these issues and sure enough, they were in the same boat as I was. They were putting away hundreds of thousands of dollars into life insurance policies and investment accounts that incurred far too much risk and produced dismal returns (and often times negative returns).

I did the research on where these clients had their money parked (which was easy to get from the life insurance companies and the financial institutions they had their investments with), and most of the time, they were in the wrong financial vehicles.

I guess being taken advantage of as a client made me even more vigilant about righting the wrongs that had been committed against other people like me by their so-called *Financial Advisors*.

This journey of financial education and recovery from my own \$1 million in losses proved to be the best thing that ever happened to me.

It ultimately led me to launch what I consider to be the most transparent, integrity-focused, cutting edge, and unbiased financial consulting firm in the industry. Our platform is unlike anything I've ever seen.

We first seek to uncover what our clients ACTUALLY have with the intention of helping them understand it. Often times, what they actually have is not what they thought it was.

Then we do the research to find out whether or not the products and programs they have in their portfolio are congruent with their financial goals. Again, usually they are NOT.

All I can tell you is that based on my experience, well over 90% of every retirement plan that incorporates life insurance is a train wreck waiting to happen.

Is that insane or what?

90% of them are just as screwed up as mine was.

They think everything's fine, but once we uncover what they actually have, they want to kill their *Financial Advisor*.

90%!

When it comes to people's overall portfolios, it's the same thing. Over 90% of them are NOT designed to maximize tax efficiency, and the majority of the time, the client doesn't realize how much they're getting charged in fees – fees that directly impact their net returns.

They don't realize all of the additional hidden fees they're getting charged, including clearing and custodial fees, third party manager fees, platform fees, transaction fees, etc.

I can almost guarantee that the fee you THINK you're paying on your investment portfolio is not the fee you're ACTUALLY paying. Often times it's two to three times MORE than what you were led to believe, and it's all buried in a portfolio ledger you'll most likely never see if you don't know what to ask for.

In the past two weeks, I've personally spoken with two very successful business owners who both thought their *Financial Advisors* were looking out for them.

The first client was a gentleman from Indiana. His *Financial Advisor* put him in a life insurance policy that was supposed to give him \$6,500,000 of coverage, as well as some heavy tax deductions. But after just five years, he came to find out that he only had \$642,483 of life insurance coverage, and he ended up owing the IRS over \$490,000 in back-taxes, penalties and interest.

The second client was a gentleman in California. His *Financial Advisor* invited him to his \$6 million home in Newport Beach, only come to find out the guy didn't even own the house. He had signed a 6-month lease on this house in order to make himself look more successful than he actually was, JUST to get my client's business. This same *Financial Advisor* took him for over \$500,000 and shortly thereafter fled to New York to escape the aftermath.

Two years ago, my firm started working with another client in Victorville, California. This gentleman is an attorney. His old life insurance agent sold him a policy that was supposed to contribute towards funding his retirement, and the life insurance coverage for this family was supposed to be *permanent*.

Once we ran the analytics, we found that his policy was scheduled to lapse at age 82. This means that if he lived to age 82, he would end up with nothing.

We reconstructed a new policy for him that gives him the same coverage until age 120, plus we generated a retirement nest egg that is conservatively projected to be worth \$3.6 million by age 82 (which is the same age his old policy was scheduled to lapse).

We accomplished this by using the exact same annual contribution he was making towards his old life insurance policy.

I could literally go on and on with example after example of how we've rescued clients from awful situations.

So you have two options.

One, you can bury your head in the sand and hope that you're NOT part of the 90% of the population who aren't headed for financial ruin.

Or two, you can have my firm review what you currently have in place to tell you the TRUTH about your financial portfolio.

We don't charge any fees for this review.

How can we do this?

An attorney asked me this question once.

He was a partner in a big international law firm with over 1,000 attorneys. He asked me how much we charge for doing life insurance reviews, because many of his clients have large life insurance policies as part of their estate plan.

When I told him we don't charge any fees, he looked at me completely puzzled.

So I put it in *attorney language* for him.

I told him it's similar to an attorney working on contingency. We do all the work up front for free because we know that 90% of the life insurance policies and investment portfolios we look at are inappropriately designed, ultimately putting the client in an adverse financial position.

We're willing to do the review at no cost because we know that 90% of the policies and portfolios we look at will need to be replaced, and when we restructure their portfolio and reallocate their assets, we get paid a commission from the life insurance company and the financial institution that invests their assets.

It's a win-win both for my firm and more importantly, for the client. That's the mission of my firm as well as my own personal mission.

Remember, I know what it's like to personally lose \$930,000 from implementing bad advice from a so-called *Financial Advisor*.

The goal of this book is to educate you on the most important aspects of financial planning, retirement planning and life insurance and eventually implement them.

I hereby present to you ***Ouch: How My Financial Advisor Lost Me \$930,000 In Three Years - And How You Can Prevent This From Happening To You.***



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# Chapter One

## Retiring Wealthy

I remember watching a famous stand up comedian talk about the difference between being *rich* versus being *wealthy*. He was talking about an NBA star, saying that the NBA star was *rich*... but the guy that signs the NBA star's paycheck... that guy was *wealthy*.

It was a hilarious skit.

But it made me think about what I consider to be *true wealth*. The definition of *wealth* to one person can be a pittance to someone else.

The concept of *wealth* is relative.

Back when I saw this stand up comedian's act, I was just getting started in my career, and like most aspiring entrepreneurs in their first year of business, I was broke.

Back then, I didn't feel the need to be *wealthy*.

I just wanted to be *rich*.

But what I didn't realize back then was being *rich* only pertains to a person's income – their current cash flow – whereas being *wealthy* has to do with long-term economic stability and assured solvency, and the freedom and power to *not participate* in economic recessions.

### **Rich People**

*Rich people*, despite them making a lot of money, are constantly stressed out about the economy, their business, and their *cash flow*.

*Rich people* live the life of luxury, but they're living paycheck to paycheck, entirely off of what cash flow allows. I know *rich people* in Newport Beach, California that make \$2 million per year in income, but they spend \$2.1 million per year.

They've got no savings.

They've got no retirement plan.

And they've got no exit strategy.

I also know *rich people* that have been prudently saving money and responsibly investing their savings in investment/retirement accounts. Everything, including their retirement, would have been secure... if it hadn't been for the S&P 500 tanking almost 40% in 2008.

The average American investor went into a panic-stricken downward spiral, hyperventilating as they lost their retirement savings.

Where was their financial advisor then?

I also know *rich people* that invested in real estate, because *everybody* knows that real estate *always* goes up. Apparently, they hadn't planned on 2008 happening either. Many of them lost their entire retirement nest egg because of that ONE tragic year.

## Wealthy People

*Wealthy people* on the other hand, whether their wealth was created due to luck, inheritance, or brilliant forecasting, have created entities that produce *passive income* – income that is generated without their direct involvement in the day-to-day operation of that entity.

This *passive income*, if created properly, can continue to be generated all the way through a person's retirement and up until death. Sometimes it can even transfer to the next generation.

This is called *residual income*.

The problem is, *true* residual income is typically created by celebrities, business moguls, and lucky sons-of-guns.

I know I'm probably coming across rather negative and pessimistic right now, but I assure you, I am VERY optimistic about the future.

Why?

Because I've discovered what I consider to be the greatest kept secret in this country when it comes to *retiring wealthy*.

But before I divulge this secret, I've got a few more things to cover that are *negative*.

Let's start with taxes.

### **Taxes: The Confiscation of Your Wealth (That YOU Built)**

Whether you're a Republican or a Democrat... whether you're left-winged or right-winged... five things are for certain.

1. Taxes are going up for everyone.
2. Income taxes for the wealthy are going up disproportionately.
3. Investors will pay higher capital gains taxes.
4. Estate taxes will continue to climb.
5. Entitlement benefits like Social Security will decrease.

If you're either *rich* or *wealthy*, you're going to get hosed on taxes.

And it won't get better for you.

It will get worse.

That's the bad news.

Now, let's get to the good news.

There are people – truly *wealthy people* – that have retired stress-free. They have tons of liquid cash that increases with market growth, insulated in vehicles that provide protection from down markets... and their families are financially set for several generations.

The *wealthy* don't work anymore.

They enjoy life.

When the market takes a dump, they're insulated.

They have 6-figure (and sometimes 7-figure) retirement incomes. And the best part is that they don't pay taxes on their income.

They don't pay taxes on their financial gains either.

The IRS knows it, and has given them tax-favored treatment, and in some cases, tax-exemption.

These people have *retired wealthy*.

So let's talk about how to *retire wealthy*... and differentiate between what's real, versus what's pie-in-the-sky mythology.

## Chapter Two

# The Myth of Residual Income

Years ago, I met a gentleman that *retired* at age 42.

At least that's what he told me.

He bragged about how he had *residual income*. I had heard about the concept of *residual income* or *passive income* before.

It was basically the concept of creating an income-producing entity that continued to produce revenue in the absence of the person who created it.

This particular gentleman had created a sales force – an organization of independent sales reps – that continually produced sales revenue, independent of this man's daily efforts.

He thought he had created *residual income*.

He thought he had created his retirement plan.

But there was a fundamental flaw in his plan.

After a few years, his independent sales reps started producing fewer sales... and a few years later, his so-called *residual income* plummeted to less than \$1,000 per month... hardly enough to retire on.

That's what happens when there's no one driving the business. That's why, for most people, the concept of *residual income* is just a pie-in-the-sky concept with no sustainability.

For most people, it doesn't exist in reality.

### **True Residual Income**

The closest thing to *true residual income* would be when a songwriter or a publishing company owns the rights to a hit song that plays over and over... and every time the song plays, the publishing company receives a residual payment.

Similarly, when someone owns a patent on an invention, or a brand name that has market value, and they enter a licensing agreement with a manufacturer (who takes on the risk and finances all production costs)... the inventor of the product (the licensor) will often receive a percentage of sales in the form of a *royalty*.

They essentially receive compensation even though they aren't actively responsible for any sales transactions or management duties... but someone still needs to run the operation without running it into the ground.

Another example of *true residual income* is when TV stars receive residual paychecks after their TV shows go into syndication. They get paid every time one of their episodes replays.

For example, in 2010, *Forbes* reported that ever since the TV show *Seinfeld* stopped recording new episodes in 1998, Jerry Seinfeld had made \$2.7 billion in residuals.

That's \$2.7 BILLION, with a B.

Not a bad *residual income*.

That's great for Jerry Seinfeld... but the problem is, unless you're a TV star... or a famous songwriter... or the inventor of an internationally renowned product... you don't have *true residual income*.

The only *true residual/passive income* that most normal people (non-celebrities) can achieve is through investment portfolios and shareholder dividends.

Even real estate investment properties require effective day-to-day management. Not that real estate investment properties are a bad investment... it's just that they *do* require active management to ensure success.

I suppose one could argue that you could hire a property management company to run the day-to-day for you, but you still need to sit on top of the management company to make sure tenant occupancy is maximized, property damage and costly repairs are kept to a minimum, and real estate values are increasing.

As the owner of an income-producing real estate property myself, and one who has a management company running the day-to-day operation for me, I know first-hand that the income I receive from my income property is far from *residual*.

Essentially, I'm a babysitter of babysitters.

Now, it may sound like I'm *poo-pooing* the concept of *passive retirement income*, but I assure you I am not.

## **Passive Retirement Income**

I'm a big believer in creating *passive retirement income*... but what I've learned from making TONS of mistakes (and losing a substantial amount of money along the way) is that when you're designing your retirement portfolio, you need to take several things into consideration.

First, you've got to evaluate the sustainability of your *passive retirement income*. Depending on how much your retirement plan is subject to market fluctuation, you've got to be careful regarding how much risk you're willing to assume.

For example, I own a vacation condo on Oahu, Hawaii.

It's a *CondoTel*, which means that it's a boutique commercial hotel, but the majority of the suites are privately owned by investors like myself.

I purchased this investment property several years ago, back when I was single. It sits on the water, right in front of my favorite surf spot about halfway between Waikiki and Diamond Head along *The Gold Coast*.

The suite I purchased was *The Honeymoon Suite*, a one-bedroom suite on the 12<sup>th</sup> floor with panoramic ocean views.

It was the ultimate bachelor pad.

Then I got married and had a kid.

All of a sudden, my one-bedroom bachelor pad wasn't meeting my new family-friendly requirements.



So I started looking at other condos, one of which was in *The Trump Tower* in Waikiki. It was a beautiful 3-bedroom condo and was on the market for \$2.1 million.

I actually met the owner/seller.

He was a successful gentleman that owned an engineering firm. The guy owned a \$2.1 million vacation home in Hawaii. He had clearly done well as a businessman.

He was 68-years old, and a pleasure to talk to.

When I asked him why he was selling it became instantly clear that my inquiry took the wind out of his sail. His countenance changed on the spot, and he became sad, depressed and disheartened.

He told me that he had sold his engineering firm in 2006 and that his stockbroker told him to take the majority of the proceeds and invest heavily in a *sure thing*.

He followed his investment advisor's advice.

That was in 2007.

Then the unexpected happened. 2008 hit, and he lost almost 40% of his retirement portfolio.

## **Failed Retirement Planning**

This gentleman found himself having to go back to work at 68-years old, as well as having to sell his dream retirement home in Hawaii because he could no longer afford the payments.

He thought his investments would pan out well, and that he'd be able to live off of the *passive income* that his investment portfolio promised to generate.

By most people's standards, he did everything *right*. However, the unexpected events of the global economy in 2008 made his retirement plan come crumbling down to the ground.

Timing can be everything.

Some people invested in real estate before the market boom in the early 2000s, and prior to the crash in 2008, they

thought they were brilliant investors. Why? Because they watched their property values double and triple in just a few short years in the early 2000's.

But after 2008, these self-proclaimed investment gurus found themselves over-leveraged and tapped out, with their real estate portfolios underwater.

The international debt market, along with the mortgage-backed securities bubble that burst in 2008, left a staggering body count behind.

Today, with underfunded pensions and the unlikelihood of Social Security being around in the future, people are worried about what will happen when they reach the age of retirement.

They've seen their *401Ks* turn into *201Ks*.

They've seen their real estate values plummet right after refinancing the property. So many of them pulled equity out of their properties to invest in yet another piece of real estate (which ALSO found itself underwater after 2008).

What happened?

2008 happened. Plain and simple.

That's the bad news.

But here's the good news.

There is another segment of the population that didn't take a beating in 2008.

## **Wealthy Retirees**

While the rest of the American population watched their retirement nest eggs get fried on a skillet, there is a group of unique individuals that are both *cash-rich* and *asset-rich*, and they are *retiring wealthy*.

When the S&P 500 tanked almost 40%, did they lose money?

No.

When the S&P 500 was up, did they experience healthy gains?

Yes.

Were their gains taxed?

No.

By now you're probably asking yourself, "*Who are these people and what the heck did they do?*"

I assure you they are no different than you.

They're not TV stars, trust fund babies or business moguls.

They're regular folks.

However, the difference between them and most people is that they had a better financial advisor who gave them better information... better options... a better financial education... and as a result, produced better financial outcomes.

So what exactly did they do?

Or more importantly, are they still doing it, and can you do it too? That's the million-dollar question.

What you are about to uncover in this book are the secrets behind how these people are *retiring wealthy*.

## Chapter Three

# The Myth of Investment Properties

Real estate *always* goes up.

At least that's what everyone always says.

The reason they say this, however, has nothing to do with their investment knowledge or their use of a crystal ball or magic wand. They say this because they're looking at historical returns.

If you could go back in time, and invest in real estate in the 1940s during the tail end of The Great Depression (assuming you had today's dollars back then), you'd be a multi-billionaire.

Under that logic, if you invested in real estate in 2009 (in the middle of another substantial economic recession), you'd come out on top of the world around the year 2060.

But would you?

This logic is only valid if history were to repeat itself. Common logic tells you that it would, but the real question is, what if history DOESN'T repeat itself?

And even if it DOES, what if you plan to make your exit (sell your real estate properties) during a time where an unexpected bad market hits you and market timing doesn't work in your favor?

That's where *timing* comes in.

You have all of these self-proclaimed investment gurus out there who claim to have the secret sauce.

If they really had financial clairvoyance, then why is it that portfolio managers can't seem to beat the S&P 500 more than two years in a row?

These arrogant investment advisors make money when you invest, whether you make money, or lose your shirt in the market.

Investing in the market is a speculative gamble to a certain degree, not that much different than attempting to count cards at the poker table.

And even if you CAN count cards, what if the next card the dealer flips is 2008?

Often times, the unexpected unexpectedly happens.

The point is, there is a certain element of risk in every so-called *good investment*, or so-called *sure thing*.

Anyway, let's get back to talking about real estate.

As I shared with you earlier, I purchased a vacation home in Hawaii back in 2005. I thought it would be a *good investment*. Real estate property values were on the rise, and oceanfront property is always scarce and in high-demand.

I figured I could rent it out as a vacation rental when I wasn't there. It had a verifiable history of rent rolls and tenant occupancy. On top of it all, I really liked the place. It sat right in front of one of my favorite surf spots on the island, and I figured I'd get a lot of personal use out of it too.

During the first full year of me taking ownership of the property (2006), my tenant occupancy was 89%.

I was elated. By the end of 2006, my property value increased by almost \$100,000.

In 2007, my tenant occupancy wasn't quite as stellar, but it was still pretty darn good. I thought to myself, "*I am SO smart! Man, I sure can pick great real estate investment properties!*"

The next year was 2008, and my tenant occupancy dropped to 36%. On top of that, my property value dropped 46% (35% lower than my original purchase price).

Ouch.

My monthly mortgage overhead for this property is \$4,828.75 per month, and with tenant occupancy dropping from 89% to 36% in less than three years, well, let's just say that put a little damper on my *Aloha spirit*.

Fortunately, I had enough discretionary cash flow from my personal income to support the mortgage payments, but it was still a major bummer.

Then it got even worse.

I found out long-term capital gains taxes were going up in 2013 for those in higher tax brackets (which included me). This changed my entire outlook on real estate investment.

Back in 2003, Federal long-term capital gains taxes were only 15% for individuals in the highest tax bracket (those most likely to invest in real estate).

That tax rate was scheduled to expire in 2008, but was extended until 2010 due to the *Tax Increase Prevention and Reconciliation Act of 2005*.

But in 2013, my Federal long-term capital gains tax went up to 20% for real estate investment gains. Add that to my California State long-term capital gains tax rate of 13.3%, plus the 3.8% Medicare tax rate for those households making over \$250,000, and my long-term capital gains tax rate is 37.1%.

So if you look at my *wonderful* Hawaiian real estate investment, I will have spent over \$1,158,900 in mortgage payments over the course of 20 years... a little more than double the purchase price of \$515,000... plus the \$103,000 down payment.

Sure, I've been able to deduct the mortgage interest along the way, and I've had some substantial rental income coming in from the property, but the problem is that the property value has dropped about 35% from my original purchase price.

If the market rebounds, and the property increases in value back to where it was when I first purchased it in 2005... well, let's do the math.

I bought the property at \$515,000. If it decreased in value 35%, that would put it at a current market value of \$334,750.

In order for it to rebound back to \$515,000... from a current basis of \$334,750... the market would have to increase by 53.8% from today... just to get the value back to \$515,000.

Will that ever happen? I don't know.

If it does, how long will it take and will I still be alive to enjoy the recovery?

Just in case the math confused you, let me break that down again. Here's some basic math.

\$515,000	Original Purchase Price (2005)
<u>- 35%</u>	Property Value Decrease
\$334,750	Current Property Value (2013)
<u>+ \$180,250</u>	<b>Needed To Regain Purchase Price (53.8% Gain)</b>
\$515,000	Original Purchase Price

If the current value is \$334,750... the property value would have to increase by \$180,250 just to get it back up to \$515,000 (the original purchase price).

A \$180,250 increase in value would be an increase of 53.8% from \$334,750 (the current market value).

In order for the property to increase in value to \$1 million, it would have to increase 298.7% from its current market value of \$334,750.

Let's just put on our optimist hat for a moment, and assume this is possible. A million dollar oceanfront, 1-bedroom condo in Hawaii isn't THAT far out of the realm of possibility.

Again, if that were to happen, the real estate market would have to increase 298.7% from today.

\$334,750	Current Property Value (2013)
<u>+ 298.7%</u>	<b>Property Value Increase Required</b>
\$1,000,000	Property Value If It Almost Doubles From Purchase

If that happens (which I am not holding my breath for), and I sell it for \$1 million (assuming I don't reinvest the money into another money pit), I'll be taxed on the gains I made.

\$1,000,000	Sale Price After 20 Years
<u>- \$515,000</u>	<b>Original Purchase Price</b>
\$485,000	Taxable Profit After The Sale

According to my so-called *gain*, I would have made a \$485,000 profit. However, I'd have to pay long-term capital gains on that \$485,000 profit at a rate of 37.1%, which means I'd owe \$179,935 in long-term capital gains tax.

\$485,000	Taxable Profit After The Sale
x 37.1%	Long-Term Capital Gains Tax
<b>\$179,935</b>	<b>Taxes Due</b>

So let's see what this investment yielded.

I would have paid in \$1,158,900 over the 20-year mortgage, and taken a tax deduction on the mortgage interest, which is substantial because I'm in a high income tax bracket (39.6% Federal and 9.3% California State, plus the additional 3.8% wealth tax imposed in 2013... taking me to a 52.7% tax bracket).

So the tax deduction on the mortgage interest (about \$643,900) would save me about \$339,335 in taxes... so it really only cost me \$819,565 net out-of-pocket.

\$643,900	20 Years of Mortgage Interest Tax Deductions
x 52.7%	Income Tax Bracket (35% + 9.3% + 3.8%)
<b>\$339,335</b>	<b>Tax Deduction Recovery</b>

\$1,158,900	20 Years of Mortgage Payments
- \$339,335	Tax Deduction Recovery
<b>\$819,565</b>	<b>20-Year Net Mortgage Payments</b>

I would have made a gross gain of \$485,000, netting \$305,065 after paying long-term capital gains taxes (assuming capital gains taxes don't go up higher than the current level, which probably will occur).

\$485,000	Gross Profit
- \$179,935	Long-Term Capital Gains Tax
<b>\$305,065</b>	<b>Net Profit</b>

So I would have paid in an after-tax total of \$819,565 and recovered \$305,065 in net profit on the sale of the property... which means that over the 20-year investment, I'm actually negative \$514,499 without the rental income the property yielded.



- \$819,565	After-Tax Net Mortgage Expense
+ \$305,065	After-Tax Net Profit
<hr/>	
- \$514,499	<b>Net Loss On The Sale (Assuming 2x Property Value)</b>

If I add in an average monthly rental income of \$3,000 per month, that's about \$36,000 per year in gross rental income.

But I pay the property management company that does the marketing, booking and maintenance for me 25% of the rental income generated, which takes my net rental income down to \$27,000 per year.

I also invest about \$3,000 per year into the property, which includes phone service, satellite TV service, internet, general supplies, and repairs.

That takes my net rental income down to \$24,000.

\$36,000	Annual Gross Rental Income
- 25%	Property Management Fees
<hr/>	
\$27,000	Annual Net Rental Income
- \$3,000	Annual Maintenance & Operational Costs
<hr/>	
\$24,000	<b>Annual Net Rental Profit (Before Taxes)</b>

So \$24,000 per year, multiplied by 20 years... that's \$480,000 in total rental income.

But that rental income would be taxed as regular income to me. For the sake of this illustration, we'll use a tax bracket of 52.7% (even though it will probably continue to increase).

\$480,000	20-Year Net Rental Profit (Before Taxes)
- 52.7%	Income Tax Bracket (39.6% + 9.3% + 3.8%)
<hr/>	
\$227,040	<b>20-Year Net Rental Profit (After Taxes)</b>

If I sold the property for \$1 million, take the \$227,040 in net rental income profit after taxes...

And subtract the \$514,499 net loss...

And subtract the \$103,000 downpayment...

And subtract the \$15,450 in real estate agent commissions on the purchase (3% of \$515,000)...

And subtract the \$30,000 in real estate agent commissions on the sale (3% of \$1,000,00)...

The total financial result of this investment property would be negative \$435,909 over the 20-year period.

I would have LOST over four hundred and thirty-five grand on this real estate investment.

Again, that's if the property value increased to \$1 million, almost DOUBLE the original purchase price of \$515,000.

And in order for this to happen, my property would have to increase in value 298.7% from its current market value... and it would have to happen within the next 13 years.

What are the chances of that happening in this economy?

Slim to none.

Now before you start feeling sorry for me, let me assure you that I *do* enjoy my Hawaii pad immensely from a personal use standpoint. It is a spectacular property.

In fact, here's the view from my balcony...



From a personal enjoyment standpoint, it's a great property. But if you look at the mathematics from an investment standpoint, the math isn't looking so hot.

You see, most people think that if I bought the property for \$500,000 and sold it for \$1 million, I'll have made five hundred grand on the deal, plus \$720,000 of passive rental income.

WRONG. Here's the *real* math on my Hawaii condo:

\$515,000.00	Purchase Price in 2005
<u>\$334,750.00</u>	<u>Property Value in 2013</u>
<b>-\$180,250.00</b>	<b>Property Value Decrease of 35%</b>
\$4,828.75	Monthly Mortgage & Property Tax Expense
x 20	Years
<u><b>\$1,158,900.00</b></u>	<b>20-Year Cash Expense</b>
\$1,000,000.00	If Value Almost Doubles From Original Purchase Price
<u>\$515,000.00</u>	<u>Original Purchase Price</u>
\$485,000.00	Taxable Gain
x 37.1%	Long-Term Capital Gains Tax Rate
<u><b>\$179,935.00</b></u>	<b>Long-Term Capital Gains Tax Due</b>
\$485,000.00	Property Value Gross Profit
<u>- \$179,935.00</u>	<u>Long-Term Capital Gains Tax</u>
<b>\$305,065.00</b>	<b>After-Tax Profit/Gain</b>
\$1,158,900.00	20-Year Cumulative Mortgage Expense
<u>\$515,000.00</u>	<u>Purchase Price</u>
\$643,900.00	Mortgage Interest (Tax-Deductible)
x 52.7%	My Income Tax Bracket (35%Fed+9.3%CA+3.8%Wealth)
<u><b>\$339,335.30</b></u>	<b>Tax Recovery</b>
\$1,158,900.00	20-Year Cumulative Mortgage Expense
<u>- \$339,335.30</u>	<u>Tax Recovery</u>
<b>\$819,564.70</b>	<b>20-Year Net Mortgage Expense</b>
\$819,564.70	20-Year Net Mortgage Expense
<u>- \$305,065.00</u>	<u>After-Tax Profit/Gain</u>
<b>-\$514,499.70</b>	<b>20-Year Cash Loss (Excluding Rental Income)</b>
\$3,000.00	Average Monthly Rental Income
x 12	Months
<u><b>\$36,000.00</b></u>	<b>Average Annual Rental Income</b>
- 25%	Property Management Fees
<u><b>\$27,000.00</b></u>	<b>Annual Rental Net Income</b>
- \$3,000.00	Maintenance Costs + Operating Costs
<u><b>\$24,000.00</b></u>	<b>Annual Rental Net Profit</b>
x 20	Years
<u><b>\$480,000.00</b></u>	<b>20-Year Rental Income Net Profit</b>
- 52.7%	Income Tax Bracket (35%Fed+9.3%CA+3.8%Wealth)
<u><b>\$227,040.00</b></u>	<b>20-Year Rental Income Net Profit</b>
- \$514,499.70	20-Year Cash Loss (Excluding Rental Income)
- \$103,000.00	Initial Downpayment (20% x \$515,000 Purchase Price)
- \$15,450.00	3% Real Estate Agent Commission (\$515,000 Purchase)
- \$30,000.00	3% Real Estate Agent Commission (\$1,000,000 Sale)
<u><b>-\$435,909.70</b></u>	<b>Total Net Loss</b>

I would actually LOSE \$435,909.70 on my real estate investment, and that's if my property value almost DOUBLES from the time of purchase.

Remember, in order for this property to double in value from the time of purchase, the property value would have to increase 298.7% its current market value in 2013 (due to it losing 35% of its original value in 2008).

So what's the point of me telling you this mini-sob story?

Am I anti-real estate investing? Of course not.

The reason this story is so important is two-fold.

First, it's important to know the real numbers. You've got to know the net-net-net numbers of what your returns ACTUALLY are, after expenses, interest and taxes have been added into the calculation.

For example, when it comes to the *actual return* of an investment, it can be very misleading when a so-called investment advisor boasts about their clients' *average returns*.

Here's what I mean.

Let's say your investment advisor produces a 50% return on your investment in year one... and in year two, they produce a 40% loss.

In that two-year period, it would be a true statement to say that the *average return* produced was 5%.

How did we arrive at that calculation?

You determine the average by adding the two returns together and dividing by two.

$$50\% + (-40\%) = 10\%$$

$$10\% \div 2 = 5\%$$

However, your *actual return* was not 5%.

It was much worse.

Using the same 2-year investment return example, if you invested \$100 in year one, and your investment advisor produced a 50% gain, your account balance would be \$150.

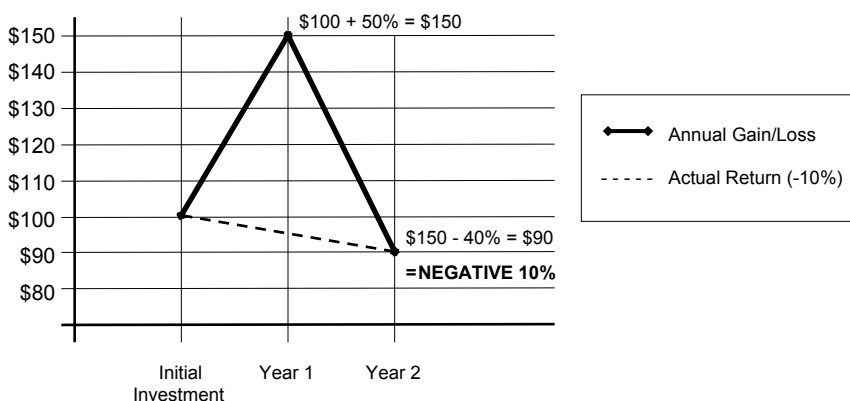
However in year two, if he produced a 40% loss, he would have lost 40% of your \$150 account balance, resulting in a new account balance of \$90 (even though you started out with \$100). So you essentially lost \$10 over the two-year period.

So your *actual return* would be **NEGATIVE 10%**.

Here's how the math works:

$$\begin{array}{r} \$100 \text{ Account Balance (Initial Investment)} \\ + 50\% \text{ Gain in Year 1 } (\$50 \text{ Gain}) \\ \hline \mathbf{\$150 \text{ Account Balance (at the end of Year 1)}} \\ \\ \$150 \text{ Account Balance (beginning of Year 2)} \\ - 40\% \text{ Loss in Year 2 } (\$60 \text{ Loss}) \\ \hline \mathbf{\$90 \text{ Account Balance (at the end of Year 2)}} \\ \\ \mathbf{- 10\% \text{ Actual Loss (over a 2-year period)}} \end{array}$$

Here's what it looks like on a graph:



Do you see how focusing on the *average return* can be extremely misleading?

You need to know your *actual return*.

Second, and perhaps most importantly, you've got to understand *risk* and how to build a hedge against down markets, protecting yourself from future 2008's that are likely to reoccur.

Now, remember those people I talked about earlier that were retiring wealthy? What they have is a *protective floor* that creates a hedge of protection against those down markets.

Let's talk about this 0% protective floor and how it works.

*Ouch: How My Financial Advisor Lost Me \$930,000 In Three Years*

## Chapter Four

### The Power Of A 0% Protective Floor

Any intelligent investor (or investment advisor) will tell you that the most important thing in protecting your wealth is having a protective hedge against down markets.

Earlier I gave you an example of the retired engineer that sold his business in 2006... but had to go back to work at age 68 after 2008 wiped out his retirement... that poor guy didn't have a hedge to protect him from the devastating losses people took in 2008.

Almost half of his entire life savings was lost in just ONE year, and he was not alone. Tons of people were affected in the exact same way.

Rebuilding a retirement fund that took a heavy hit takes YEARS... and when you're 68-years old you don't have time on your side to recoup your losses.

In the example I gave you regarding my Hawaii property taking a 35% hit in 2008, that loss happened as a result of just ONE bad year.

The point is, just ONE bad year can practically wipe out everything you worked for... and if your retirement nest egg gets wiped out, or even just 40% wiped out, your game plan changes dramatically.

If it happens too close to the time you planned on sailing into the sunset, you won't have enough wind in your sail to even leave the dock.

To illustrate this point, let's take a look at a hypothetical index. I'm going to show you some examples of how *timing* can be everything.

In addition, I'm going to show you a concept I call *The Power of A Protective Floor*.



This concept will make you think very differently about investments, risk tolerance, and your ability to participate in market growth without incurring the risk that most investments cannot insulate you from.

The point is, no one can predict the market.

Depending on when you're going to retire, if the market does well in the years prior to retirement, you could end up just fine.

But if the market takes some heavy hits (or in the case of 2008, just ONE heavy hit), you could end up in a financial position where you couldn't afford to retire.

This is why so many of my clients are allocating a substantial part of their overall portfolio into products that have a 0% protective floor.

There are some financial vehicles that have a built-in 0% protective floor. The general concept, in layman's terms, is that when the market's down and producing negative returns, while everyone else is losing money, you don't lose anything.

You're probably asking yourself, "What's the catch?"

The *catch* is that in order to eliminate downside risk, you give up a little bit of the upside.

There are different options you can go with when it comes to this concept.

The one I currently favor has a 0% floor and a 5-point market shadow. Here's how it works.

If the index performs at 35%, you'd get 30%.

If the index performs at 25%, you'd get 20%.

Now, if the index produces a *negative* return in any given year, with a 0% floor, you wouldn't lose money.

So if the index performs at 5%, you'd get 0%.

If the index performs at 0%, you'd get 0%.

And the index performs at -37%, you'd still get 0%.

This 0% protective floor protects you from down markets. So what would have happened if you wanted to retire in 2009?

In 2008, most people took a 37.00% hit.

This was the case of the guy selling his Hawaii condo in Trump Tower. He literally couldn't afford to retire because of just ONE bad year.

That's the power of the protective floor.

Now, remember those lucky sons-of-guns that I mentioned earlier in this book that are retiring wealthy?

They're essentially putting their money in a vehicle that has this 0% floor.

But that's not all.

They're not paying taxes on their gains either.

In this next chapter, I will divulge their secret... how they're doing it... and how you can do it too.

*Ouch: How My Financial Advisor Lost Me \$930,000 In Three Years*

## Chapter Five

### Retiring On Your Life Insurance

This vehicle with a 0% protective floor that I've been talking about is actually a very specific type of life insurance product.

Can you believe that?

Life insurance of all things.

Most people have never even heard about this.

I know this sounds crazy, but I assure you, I have not been taking crazy pills.

Let me explain.

But before I get into the specific details of this strategy, let's talk conceptually about how you can use life insurance as a tool to supplement your retirement income.

There are five main reasons why life insurance can be such a powerful part of your retirement portfolio.

1. Tax-Free Cash Accumulation
2. Tax-Free Retirement Income
3. No Early Withdrawal Penalty Prior to Age 59½
4. No Limits on Contribution Amounts
5. No Required Minimum Distributions (RMDs)

Let's discuss each of these benefits and how they compare to other retirement options and vehicles.

Before I begin, let me clarify that I am not suggesting that 100% of your retirement allocation should be life insurance based.

That would be crazy.

But what I AM saying is that there is such a lack of understanding and awareness regarding the benefits of using a life insurance policy to supplement a person's retirement, it's shocking.

Here are the top five reasons to use a life insurance policy to supplement your retirement.

### **Reason #1: Tax-Free Cash Accumulation**

I'll often ask people the question, "*What do you think will be the biggest expense you're going to have in your life?*"

They typically respond by saying, "*My house.*"

Wrong.

The largest expense you're going to incur over the course of your life is paying *taxes*.

If you're making a substantial multi-six-figure income, about half of everything you earn is going to be confiscated from you by the government in the form of *taxes* at many levels.

That's what makes *Cash Value Life Insurance* such a powerful vehicle. As your life insurance policy's *Cash Value* grows, it compounds tax-deferred.

*Cash Value* is essentially excess premiums that sit inside the policy to pay for future premiums in the event that you cannot afford to pay them due to an economic hardship.

By design, the intention of *Cash Value* was to further protect the client in the event of economic hardship.

The allowance of *Cash Value* growth to be non-taxed is based on this intention. For more information on this issue, refer to *IRS tax code Section 7702*.<sup>1</sup>

That's what makes some life insurance policies whose *Cash Value* is linked to an index (such as the S&P 500, the Euro Stoxx 50, the Hang Seng, etc.) so attractive.

You get to participate in market growth, but also enjoy your gains tax-free.

Tax-free accumulation and tax-free liquidation.

Sound good?

Let's discuss how to do it properly, and why the liquidation is tax-free (if done properly), as well as some of the

major pitfalls when working with a financial advisor or life insurance agent that doesn't know how to advise you properly.

## **Reason #2: Tax-Free Retirement Income**

How can a life insurance policy produce tax-free income in addition to tax-free growth?

It depends on how you pull the money out.

If you decide to *surrender* the policy (cancelling the policy) and you pull 100% of the accessible *Cash Value* out at once (the *Surrender Value*), you will have to pay taxes on the gain over *basis*.

However you pull some of (even the majority of) the *Cash Value* out of the policy without paying taxes on the gains assuming you are mindful of the *cost basis*. The term *basis* refers to the original dollar amount paid into the policy.

In other words, if you paid \$100,000 of premiums into the policy, your *basis* would be \$100,000.

If your *Cash Value* grew to \$250,000, and you pulled out the entire \$250,000 which would cancel the policy, you would pay taxes on the \$150,000 gain.

That's why surrendering the policy is typically NOT to your advantage.

Instead, my firm specializes in designing well-planned exit strategies when it comes to withdrawing retirement income from your life insurance policy in a way that produces tax-free liquidation.

Cash distributions from a life insurance policy are treated on a *FIFO* basis. If you have an accounting background, I'm sure you're familiar with the term *FIFO*.

If you don't have an accounting background, you probably have no idea what I'm talking about, so let's discuss.

*FIFO* is an acronym for *First-In, First-Out*. From a tax-treatment standpoint, this means that the *first dollars* that went

into the policy (which are typically after-tax dollars) are the *first dollars* to come out of the policy when taking cash distributions.

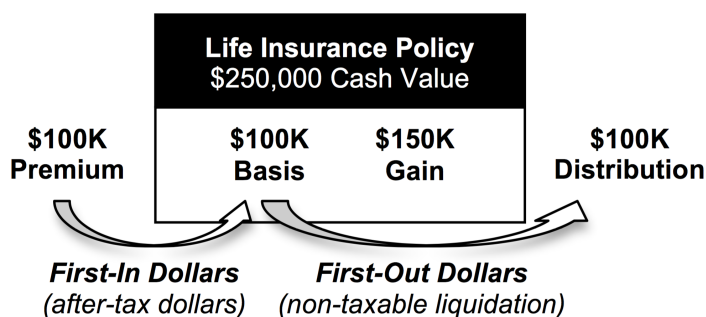
In the case of a life insurance policy, the *first dollars* would be the premium payments paid into the policy.

So let's say you paid \$100,000 in total premiums into the policy. These would be the *First-In* dollars.

Since these are after-tax dollars, when you take your first \$100,000 of cash distributions out of your life insurance policy, you do not pay taxes on your distributions (because you already paid income tax on this money prior to making premium payments).

These were your *First-In* dollars, and now that you're taking cash distributions, these are your *First-Out* dollars.

Here's a diagram that illustrates the basic concept of *FIFO*.



In this example, the \$100,000 we just discussed is *basis*.

Now remember, in the case of some permanent life insurance products, you could be earning interest and/or dividends and/or market returns and/or index returns on your *Cash Value*.

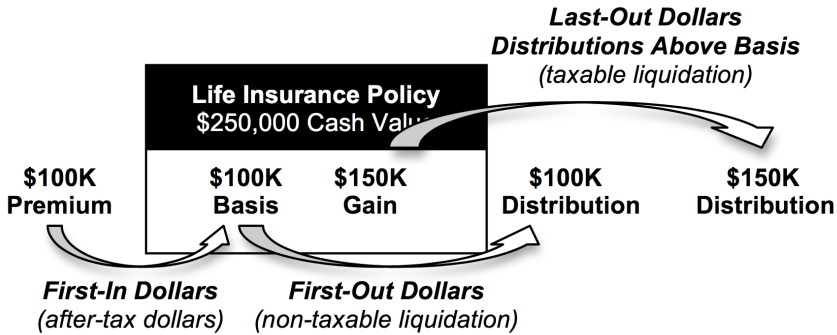
Any gain you may experience above *basis* accumulates tax-deferred.

However if you take cash *distributions* from your life insurance policy, any *distributions* you take above *basis* are taxable.

In other words, you're taxed on the gain.

There is a way to avoid this from happening. But before I explain, let's take a look at the concept of *gains above basis*.

Here's a diagram that illustrates distributions above basis.



Wait a minute!

What about the tax-free retirement income that those people were getting we described at the beginning of this book?

How did they get around this?

This is another one of many reasons why it's so important to work with a life insurance agent that REALLY knows how to design your strategy properly.

The key is to design your exit strategy so that all cash withdrawals above *basis* are NOT taken out in the form of *distributions*.

They must be taken out in the form of *policy loans*.

This may sound like we're playing semantics, but if you do not do this properly, you'll find yourself getting hit with phantom income tax... and that can be a rude awakening.

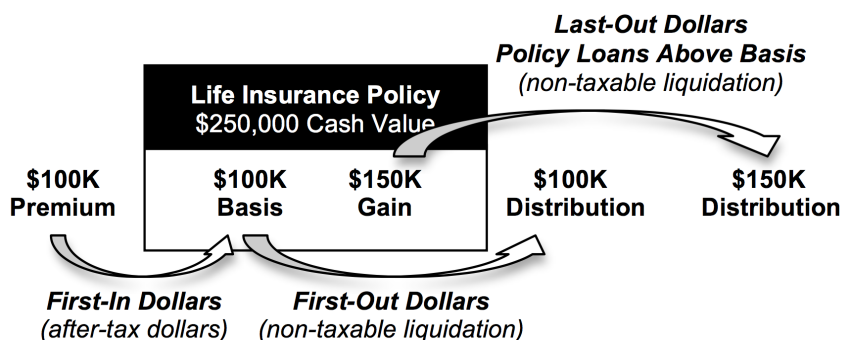
If you do this properly, you'll *retire wealthy*.

You see, if you take cash withdrawals above *basis* in the form of *policy loans*, the retirement income you receive is NOT taxable.



Let's take a look at how cash liquidation above basis should occur to avoid paying phantom income tax on distributions above basis.

Here's a diagram that illustrates policy loans above basis.



Policy loans are essentially loans that the insurance carrier gives you using the *Cash Value* of your policy as collateral.

Typically, once you're in a position in life where you want to start accessing your *Cash Value* (usually when you want to begin receiving retirement income), you can pull out the majority of it in one lump sum (usually up to 80%-90% of the *Cash Value*) and still keep the policy in force.

The reason you'd want to keep it in force is so that you don't surrender the policy and incur tax liability.

A better option is to take out incremental distributions over a number of years (instead of taking out a large lump sum).

Here's why.

When you take policy loans over say 20 years for example, the total net amount you receive tends to be significantly larger than pulling the majority of the money out at once because the bulk of the money remains in the policy, continuing to earn interest and possibly dividends, market returns, or index returns, with each compounding in your favor, year after year.

The reason policy loans are not taxable is because by definition, they are *loans*, and loans are not taxable.

For example, if you went to the bank and took out a loan, you don't pay income tax on the money you borrow. It's the same thing with policy loans.

In theory, you could repay the policy loan amounts, but typically, most people just allow them to be paid off with a portion of the remaining death benefit amount after they die.

So from a cash transaction perspective, although the loans are technically paid off by the insurance contract value, neither you nor your family have to write a check to the insurance carrier to pay off the loan.

There are several different types of policy loans you can take, but I'll just briefly discuss two:

1. Fixed Loans
2. Participating Loans.

For the sake of this explanation, we'll use an *Indexed Universal Life* policy as an example.

Let's start with *Fixed Loans*.

## **Fixed Loans**

*Fixed Loans* tend to be the simplest and most conservative of policy loan options.

For example, let's say a policy's *Fixed Loan Rate (FLR)* is 5%.

This loan rate is often offset by what the policy credits you. So if the policy credits 5% for example, and the *Fixed Loan* rate is 5%, you'd be left with a net zero loan.

This is what we call a *Wash Loan*.

Essentially, the policy's *crediting rate* washed out the policy's *loan rate*.

## **Participating Loans**

The second type of loan rate is called a *Participating Loan Rate (PLR)*. Some insurance companies will refer to the *PLR* as an *Indexed Loan Rate* or an *Alternate Loan Rate*.

There are several different *PLRs*, and each insurance carrier has their own version of the *PLR*.

For the sake of this discussion, we'll only discuss one.

Let's say the insurance carrier uses the *Moody's Corporate Bond Rate* for their *PLR*, and let's say for the sake of this discussion that the *Moody's Corporate Bond Rate* is at 4%.

If the policy's index were crediting at 7%, then you'd experience a 3% *positive arbitrage*.

7%	Index Market Return
- 4%	Participating Loan Rate
3%	<b>Positive Arbitrage</b>

However, if the policy's index credits 3% in that given year, and your *Participating Loan Rate* is 7%, then your policy will experience a -4% drag/loss.

3%	Index Market Return
- 7%	Participating Loan Rate
- 4%	<b>Policy Drag/Loss</b>

Whether you decide to take *Participating Policy Loans* or *Fixed Policy Loans* is up to you.

Obviously, *Participating Policy Loans* come with a bit more risk, however the upside of the positive arbitrage can boost your cash value growth substantially. Historically, Indexed Universal Life Insurance policies have produced 7% - 8% returns, so using an example of a 7% index market return is very realistic. In fact, between the years of 2006-2015, Pacific Life's *Indexed Universal Life Insurance* policies have produced an 8.58% IRR.

My advice would be to look at both *Fixed Policy Loans* as well as *Participating Policy Loan* options. In most cases with most insurance carriers, you can change your decision as to what method you want to use on an annual basis.

The bad news is that I've seen insurance agents show clients retirement incomes ONLY using *Participating Loan Rates*, and they ONLY showed the index crediting at a level that created positive interest arbitrage gains EVERY year.

In my opinion, this is truly manipulative because it assumes that the index will ALWAYS outperform the *Participating Loan Rate (PLR)* every year, which is logically and historically unrealistic.

So if you're contemplating working with one life insurance agent versus another, and one agent is showing you a substantially larger retirement income stream, make sure they're not manipulating the *Participating Loan Rate (PLR)* and index crediting amounts to create a false sense of perpetual positive arbitrage security.

I hate to say this, but it's been my experience that many agents will either manipulate these numbers, overpromising their clients (because the client doesn't know any better), or the agent is not experienced enough to know the difference, making them incompetent to serve your best interests.

Policy distribution and loan strategies, as well as your entire life insurance policy design, is serious stuff... and if not designed properly by an extremely talented advisor, you could end up in a financially devastating situation.

In my opinion, the problem with the insurance industry as a whole (and I can say this because I am a licensed insurance agent myself) is that the barrier to entry in our industry is too low.

The only thing you have to do in order to become a licensed insurance agent is take an online class and take a relatively basic exam with the state... and you only have to score a 60% to pass the exam in the State of California, for example.

That's it. Is that scary or what?

You'll also have insurance agents that brag about how many years they've been doing this, which is equally as hilarious. In many cases, all that means is that they've been leading their clients down the wrong path for a longer number of years.

The key to choosing the right financial advisor or insurance agent is for you to truly understand the concepts I'm outlining in this book.

The challenge is that for most people, the only source of information they have about life insurance is from the life insurance agent that sold them the policy or some family member or friend who is equally ill informed.

That's why I wrote this book.

If you can understand the basic principles in this book, you will probably know more about life insurance than 90% of the life insurance agents out there... and that is a sad thing to say about an industry that is so vital to helping people properly structure their retirement strategy, as well as with critical financial challenges.

Okay, enough bashing other life insurance agents for now.

I'll revisit this topic again later in the book.

### **Reason #3: No Early Withdrawal Penalty Prior To Age 59½**

There are obviously other financial vehicles you can use for retirement purposes outside of life insurance. In fact, I use several of them myself.

Again, the goal of this book is not to promote the idea that you should **ONLY** use life insurance as your sole vehicle in allocating your money towards retirement.

It's just ONE vehicle... but it is a darn good one.

Another huge advantage of life insurance is that unlike several retirement programs, you don't have to wait until you turn 59½ years old to start pulling money out.

Both IRAs and 401Ks have restrictions regarding when you can start accessing the cash in your account. If you start accessing the money prior to age 59½, you'll pay a 10% penalty plus you'll be taxed on all of your gains.

With life insurance, you can start accessing the *Cash Value* prior to age 59½ without paying any penalties, depending on how

the policy is designed, as well as how many years you've paid into the policy.

Now, obviously every insurance carrier and every insurance policy has its opportune time for the policy owner to access the *Cash Value* based on compounding and the *time value of money*, but the point is, life insurance allows for a tremendous amount of flexibility when it comes to accessing your money.

Typically, life insurance companies can turn around your request for funds to be dispersed within a week or less.

#### **Reason #4: No Limits on Contribution Levels**

There are some other retirement-oriented vehicles that grow tax-free, like a Roth IRA for example... but with Roth IRAs and most other non-qualified plans, there are limits regarding how much you can put away into these vehicles.

For 2015, the maximum contribution allowable was \$5,500 per person (\$6,500 if you're age 50 or older). Not that this is a bad thing to do, and can be a prudent thing for most people to do.

But putting five thousand bucks a year into a Roth IRA is about as significant as putting pennies into a ceramic piggy bank.

You could do it, but it's not enough.

And if you're making over \$193,000 per year in income, you aren't even eligible to contribute to a Roth IRA.<sup>2</sup>

In addition, if you die before you begin to enjoy the benefits of a Roth IRA's retirement income distributions, there is no death benefit to your loved ones. They merely get the Roth's account balance. However with life insurance, your loved ones would receive a substantial financial benefit upon your unexpected death.

Many people that understand the value of using the tax-free compounding of *Cash Value* within a life insurance policy to supplement their retirement don't look at life insurance premium payments as a *cash expense*.

They look at it as a *cash allocation*.

They'll ask themselves the question, "How much do I want to allocate per month towards funding my retirement?"

They look at it as an *allocation*, not an *expense*.

This is an interesting question to ask yourself, because it may help you decide how much you want to put away into your life insurance policy.

Obviously the primary purpose of life insurance is for the death benefit to go to your loved ones, but when using a *Tax-Free Cash Value Accumulation* strategy, the benefits of killing two birds with one stone – death benefit and retirement income – are huge.

The broad concept is that if you're going to use a life insurance policy to supplement your retirement and create a tax-free retirement income stream, the net cash-in/cash-out outcome will typically put you *in the black*.

In other words, the amount of *Cash Value* you can accumulate will often times be substantially larger than the amount of premiums you paid into the policy at the end of the rainbow.

So for example, if you paid \$100,000 in to the policy, but your *Cash Value* is \$250,000 over the course of several years, your cash-in/cash-out result puts you at a *profit* of \$150,000.

So in this scenario ask yourself, were the premiums you paid for your life insurance policy a net *expense*, or were they an *allocation* towards your retirement that ultimately netted you a gain?

And if the cash-in/cash-out numbers netted you a gain, what did the life insurance coverage actually cost you over time?

Your balance sheet would show a net-zero cost, and a six-figure gain.

We've had clients put away several hundreds of thousands of dollars per year into life insurance policies, not only because they wanted massive amounts of insurance coverage, but they also wanted to maximize the tax-free cash accumulation inside the policy to use for their retirement.

We've also had clients that wanted to pay larger amounts per year over a shorter number of years, in order to maximize the cash compounding, taking advantage of the *time value of money*.

These clients have decided to frontload premium payments into the first seven years, or five years, and then pay no more premium payments after that period.

Then at age 65... or 70... or 71... or whatever age they feel like it, they'll start taking withdrawals and policy loans to fund their retirement.

The income flow they'll receive will be tax-free, assuming it was set up properly.

The amounts they can contribute toward a life insurance policy for these purposes are NOT subject to the limitations that many qualified and non-qualified retirement plans are subject to.

You can dictate how much you want to allocate towards this vehicle, which will obviously affect how much life insurance coverage you will have.

The only real limitation regarding the contribution amount is that there must be a realistic insurable need, which is calculated based on a person's income and net worth.

To find out the *real truth* and the *real math* in regards to moving liquid assets from a traditional investment account to an *Indexed Universal Life Insurance* policy, read the final chapter of this book. I'll show you the *real numbers* in a side-by-side comparison between the two using the same contribution amount. I'll show you the net after-taxes and after-fees returns of both and let you decide for yourself what the best option is for you.

We've also had several clients reallocate funds previously held in *Bonds*, *Mutual Funds* and *Savings Accounts* towards life insurance policies to accumulate tax-free cash value accumulation.

One of their primary goals was to take advantage of the tax-free growth, achieve tax-free retirement income, and *retire wealthy*.

They look at life insurance as an *asset class* on their balance sheet, as opposed to an *expense*.



In addition to individual clients, guess who else is heavily funding *Cash Value Life Insurance* policies, using them as an asset class.

Banks.

According to the FDIC, as of December 31, 2012, *Bank of America's* balance sheet listed over \$19 billion in Life Insurance Assets (*Cash Value* of bank-owned life insurance policies), compared to \$13 Billion in Real Estate assets owned, and \$4 Billion in Common Stock.<sup>3</sup>

Wells Fargo had \$18.1 billion in cash value, and JP Morgan chase had \$10.2 billion.

Here's a snapshot of these asset classes from the balance sheets of three major banking institutions.

	<b>BANK OF AMERICA 12/31/12</b>	<b>WELLS FARGO 12/31/12</b>	<b>JP MORGAN CHASE 12/31/12</b>
<b>Life Insurance Assets:</b>	\$19,928,627,000	\$18,165,156,000	\$10,200,000,000
<b>Bank Premises, Fixed Assets And Other</b>	\$13,868,388,000	\$11,650,749,000	\$13,117,425,000
<b>Real Estate Owned:</b>			
<b>Common Stock:</b>	\$4,296,843,000	\$590,850,000	\$1,835,100,000

Notice where these major financial institutions have their chips stacked on their balance sheets.

According to the FDIC, both *Bank of America* and *Wells Fargo* have more in Life Insurance assets than they do in Real Estate assets.

In fact, *Bank of America* has 43.7% more of their capital allocated towards Life Insurance assets than Real Estate assets.

*Wells Fargo* has 55.9% more of their capital allocated towards Life Insurance assets than Real Estate assets.

The reasons banks use life insurance policies as an asset class are:

1. The tax-deferred growth of the life insurance policy's *Cash Value*.
2. The solid rate of return, relative to the minimal risk.
3. The liquidity of the life insurance policy's *Cash Value*.

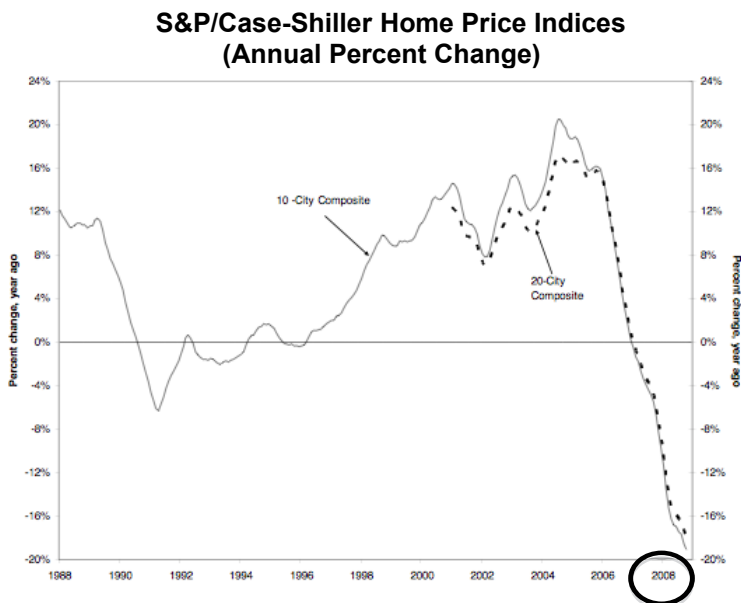
Despite Real Estate being a viable asset class, it is not a liquid asset, nor would it be placed in the *minimal risk* investment category.

In down markets, Real Estate assets can take a beating.

If you were investing in Real Estate in the mid 2000's, just remember what happened to your property values in 2008.

Here's what the Real Estate market did on a national level between 1988 and 2008, according to the S&P/Case-Shiller Home Price Indices<sup>4</sup>.

Notice what the Real Estate market did in 2008 (circled in the bottom right corner):



Down markets have historically cycled about every ten years, and obviously these markets cycle back to positive years.

But as we discussed earlier, timing can be everything.

If you were looking to retire in a year that had been preceded by a down market year (or a series of consecutive down market years), your retirement nest egg might have been pushed off the wall like *Humpty Dumpty*.

Remember the owner of the engineering firm I told you about earlier that I met in Hawaii?

Prime example.

The same concept applies to equities (stock market investments) as well. All three of the major banks we just looked at have between FIVE to THIRTY times more capital allocated towards Life Insurance assets than they do towards Common Stock.

That's got to tell you something.

I'm not implying that you shouldn't invest in the stock market.

All I'm saying is that while so many Americans invest so heavily in Real Estate and the Stock Market, very few allocate as much of their capital towards *Cash Value Life Insurance* policies.

Isn't it ironic that banks typically recommend that their clients invest in *CDs* and non-life insurance based securities?

Think about it.

Have you ever had your banker show you the advantages of using *Cash Value Life Insurance* as an asset class?

They're giving their clients financial and investment advice that is in direct opposition to what they're doing themselves.

I also find it ironic that the average American investor has their capital asset portfolio structured with very little allocated towards life insurance.

Perhaps not-so-ironically, the average American does not *retire wealthy*.

A general rule of thumb is that if you do what *most people* do, you'll end up with what *most people* have, including:

1. Financial stress.
2. Debt.
3. Underfunded retirement plans.

### **Reason #5: No Required Minimum Distributions**

Another huge benefit of using life insurance as a retirement supplement tool is that there are no *RMDs (Required Minimum Distributions)*.

With many retirement programs, you are required to take a minimum amount of distributions at a certain age. For example, if the retirement account is an IRA, when you reach 70½ years of age, you are FORCED to begin taking *Required Minimum Distributions* on time, every year, in the correct amounts.

If you don't, you'll get hit with some stiff penalties for failure to take *RMDs*.<sup>5</sup>

Other retirement accounts that are subject to *RMD* requirements include 401(k) plans, 403(b) plans, traditional IRAs and IRA-based plans such as SEPs and SIMPLE IRAs.

With life insurance, you are not subject to any *RMD* requirements. You can let your *Cash Value* continue to compound, year after year, regardless of your age and regardless of how many years you've paid into the policy.

In fact, if you never feel the need to touch your *Cash Value* and take policy loans for retirement income, you can choose not to take any, and just give your heirs the maximum death benefit your policy allows at the time of death, never having taken out any policy loans or distributions.

When it comes to life insurance cash liquidation, YOU are in control.

*Ouch: How My Financial Advisor Lost Me \$930,000 In Three Years*

## Chapter Six

### The Best Kept Secret

By now, you're probably thinking to yourself, "*This sounds too good to be true.*"

I completely understand.

I said the same thing when I first began investigating this strategy, while doing my own personal due diligence.

But here's what I found.

If designed incorrectly, your life insurance policy can turn into an absolute nightmare, costing you hundreds of thousands (if not millions) of dollars. In fact, your current life insurance policy might be headed for disaster right now, and in most cases, you wouldn't even know it.

Similar to your health, you should have it evaluated and reviewed on an annual basis.

However, if designed properly, a life insurance policy can be one of the greatest financial blessings you will ever know.

Life insurance is one of those things that you don't get too fired up talking about, because it involves your death some day.

I've heard people say that life insurance is one of those things you buy, hoping you get *screwed*... because if you get your money's worth, it means you're dead.

As funny or crass as you may think that tongue-in-cheek joke is, the reality is that most people look at life insurance as an *expense* that you incur because you're responsibly protecting your family in case you die unexpectedly.

To a certain degree, that is true. But that's really only a small piece of a much bigger picture. Remember what I said in the beginning of this book about the select few that are *retiring wealthy*?

The irony of these people's situation is that they used a certain type of life insurance contract to strategically accomplish three things:

1. Protect their family in case they die unexpectedly.
2. Provide their kids enough money to pay estate taxes when they inherit their wealth (assuming their estate is large enough to trigger an estate tax liability).
3. Supplement their retirement with tax-free income.

Usually, people are familiar with #1 and #2... but most people don't truly understand #3. In my opinion, this is the *Best Kept Secret* in the financial world.

Before I get into the details of how some life insurance policies can be linked to an *index*, let's first discuss the positive attributes of using life insurance as a retirement supplement, as well as for protecting your family.

If you've never heard of this concept before, I'll break it down in layman's terms. There are two basic categories of life insurance:

1. Term Insurance
2. Permanent Insurance

## **Term Insurance**

Term insurance tends to be the cheapest in terms of the monthly cost, and covers you for a prescribed period of time.

For example, let's say your \$500,000 mortgage will be paid off in 30 years, and you only want life insurance to cover that debt.

You could buy a 30-year term policy that covers you for \$500,000. Under this simple policy, if you died within the next 30 years, your beneficiary (usually your spouse or domestic partner) would get \$500,000.

But if you live past the 30-year mark, your coverage would come to an end, and all the money you paid into the policy is

gone. It's kind of like *renting* a house versus *buying* a house. Sure, the rent was a cheaper monthly cost, but at the end of the rental term, you've got nothing to show for it.

Term insurance is pretty simple and straightforward.

But term insurance doesn't help you with creating a tax-free retirement income stream. On the other hand, some permanent insurance policies DO produce a tax-free income stream.

The tax-free income stream is generated due to *Cash Value* accumulation within the policy.

This concept of *Cash Value* is a relatively complex formula that can involve a combination of interest-earned and dividends-received, minus the cost of insurance that an insurance carrier credits/debits on every dollar you pay into a permanent life insurance policy.

Rather than get into the complexities and proprietary formulas of how the *Cash Value* is calculated, I will attempt to break it down into simple terms.

## **Permanent Insurance**

In the types of permanent life insurance policies I am about to discuss, a certain amount of your life insurance premiums (payments) go towards the raw cost of insurance, and a certain amount goes towards your *Cash Value* accumulation.

Think of it kind of like a savings account on steroids, imbedded inside your life insurance policy.

My *savings account on steroids* metaphor is obviously not a technical term, nor is it a completely accurate depiction of what *Cash Value* actually is, but hopefully you get the general picture.

This *Cash Value* is money that you own.

When you buy a permanent life insurance policy, at any given time, you can request an in-force illustration of your policy, which is basically a report that shows you how much *Cash Value* you have in your policy.



Once your *Cash Value* builds up to a significant amount, in most cases, you can start pulling chunks of money out of the policy in the form of *policy loans*.

These *loans* are not subject to income taxes or capital gains taxes, and can create a substantial supplemental retirement income.

Let's talk conceptually about the different types of permanent insurance policies.

First and foremost, a permanent life insurance policy's primary objective is to provide a death benefit for your heirs, providing them with that piece of mind up until the day you die... whether you die at age 70, 80, or even 120.

In addition to the death benefit of a life insurance policy, there are IRS-approved financial strategies that allow you to use certain life insurance policies to supplement your retirement. Most people have no idea you can actually do this.

## **The Different Types Of Permanent Life Insurance**

There are different types of permanent life insurance options available. We'll discuss four basic categories.

1. Traditional Universal Life (UL)
2. Variable Universal Life (VUL)
3. Indexed Universal Life (IUL)
4. Whole Life (WL)

### **Traditional Universal Life**

*Traditional Universal Life*, or *UL* as we call it, is typically best suited for someone that wants the largest amount of permanent life insurance coverage for the least amount of money.

Of all the permanent life insurance types, *UL* typically provides the least amount of *Cash Value* accumulation.

So why would someone go with *UL* when it doesn't accumulate much *Cash Value*?

*UL* is great for someone who isn't interested in using his or her life insurance policy as a retirement supplement component.

For example, if you were going to put your life insurance policy inside a family trust, and you just wanted to leave behind a fixed death benefit amount, then *UL* is great.

Again, *UL* is typically NOT used to create a tax-free retirement income.

Let's move on to the next type of permanent insurance.

### **Variable UL**

*Variable Universal Life*, or *VUL* as we call it, does have the potential to accumulate *Cash Value*. The *Cash Value* growth is linked to a *separate account* (similar to a Mutual Fund), and it allows the policy owner to actively manage their account. Essentially, it allows the policy owner to sort of be his or her own little stockbroker inside their life insurance policy.

If you're into that sort of thing, or if you enjoy being a part-time day trader, *VUL* can be a good option. However, in these economic times, I've found that most of my clients don't want to get into all of that, nor are they qualified to do so.

But for someone that wants to manage the investments within their life insurance policy, *VUL* can be a great option.

However, in light of recent global and domestic economic events, many Americans have become more conservative regarding their investment risk tolerance.

With *VUL*, the upside is that you can ride the market all the way to the top, maximizing your returns, but you do run the risk of losing everything because there is no *protective floor*.

### **Indexed UL**

*Indexed Universal Life*, or *IUL* as we call it, is a great product for someone that wants to maximize *Cash Value* growth potential while limiting their potential losses with a protective floor.

An *IUL* policy's *Cash Value* growth is linked to how a particular index is doing. Some *IULs* are linked to the S&P 500... some are linked to the Euro Stoxx 50... some are linked to the Hang Seng... and some are linked to several other index options, including diversified global markets and emerging markets.

The chart below illustrates the power of *IUL* design.

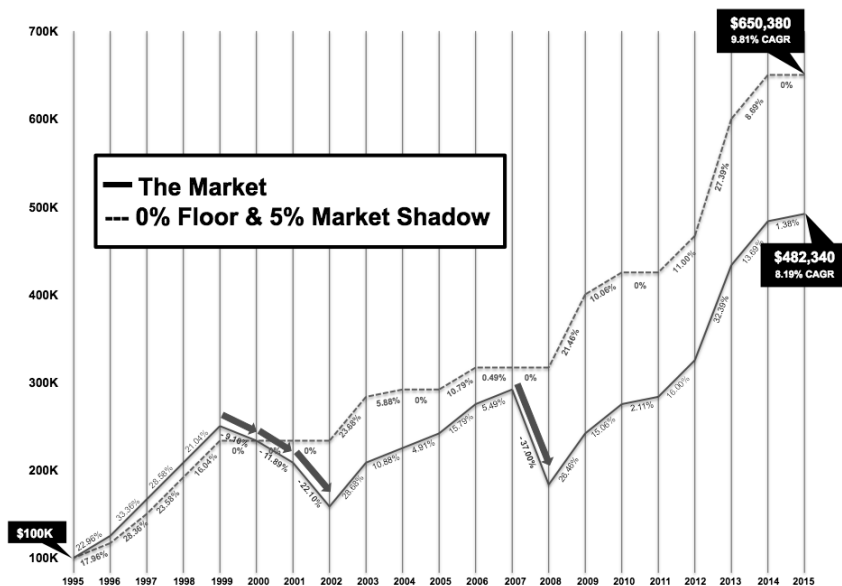
The solid line represents the market. The dashed line represents the *IUL* design with the 0% protective floor and the 5-point market shadow.

Let's say you started out with \$100,000 in 1995.

In 1996, the market did 22.96%, so you would have gotten 5-points less at 17.96%.

The next year in 1997, the market did 33.36%, so you would have gotten 5-points less at 28.36%. During the next two years, same thing.

But between 2000, 2001 and 2002, the market was down. So while everyone in the market got negative returns in these three years (-9.10%, -11.89% and -22.10%), if you were in the *Indexed Universal Life* policy, you would have lost nothing because of that 0% protective floor.



The next 5 years between 2003-2007, the market had a nice bull run, so you would have gotten the same thing minus 5-points.

But the year after that was 2008, and the market tanked 37.00%. While everyone in the market lost 37.00%, if you were in the IUL, you would have lost nothing because of the 0% protective floor.

Now for the next seven years, the market had another bull run, back-to-back positive returns for seven years in a row, but it never caught back up to the cash value performance in the IUL due to those down years.

The market (the solid line) produced a compounded annual growth rate of 8.19% so the initial \$100,000 one-time investment would have grown to \$482,340.

However the IUL produced a 9.81% return, resulting in \$650,380.

Of course this does not take into consideration the cost of insurance, however I illustrate a highly detailed comparison between buying Term life insurance and investing the difference in the market, versus the cash value performance in an IUL in the final chapter of this book.

The concept I'm trying to reinforce here is the power of the 0% protective floor.

Another great feature of policies that are built on a *UL* chassis (ie: *Traditional UL*, *Variable UL*, or *Indexed UL*) is that you have the benefit of flexible premium payments, meaning that if you have a bad month in business and you can't afford to pay the premiums in a given month, you can actually skip premium payments, deferring them into the future, so you're not necessarily locked into a set monthly financial commitment.

Long story short, there are a ton of different options within an *IUL* policy's design. I would recommend that you spend a significant amount of time discussing these options with your financial advisor in order to decide which strategic design is best for you.

## Whole Life

For people that are more conservative in nature that want permanent life insurance, *Whole Life* insurance can be an excellent option.

*Whole Life* insurance can accumulate *Cash Value*, and credits a fixed, guaranteed internal rate of return. If the insurance carrier is a mutual company, your *Cash Value* growth is typically based on two variables:

1. A fixed, guaranteed interest rate.
2. Dividends, which are declared and credited each year.

The dividends credited to you are based on how profitable the insurance carrier was in the previous year. The combination of the fixed interest rate, plus the dividend crediting rate, can give you a good, solid, conservative return.

History has told us that the S&P 500 has averaged a greater rate of return than most *Whole Life* policies, however for someone that isn't comfortable putting their financial future in the S&P 500 (or any other index, domestic or global)... and they like the concept of guarantees... *Whole Life* is often the best fit for them.

## Tax-Free Cash Accumulation

*UL*, *VUL*, *IUL*, and *Whole Life* all allow you to participate in tax-free *Cash Value* accumulation, and if designed properly (assuming you're working with a talented financial advisor that specializes in maximizing *Cash Value Accumulation Strategies*), you can enjoy:

1. Tax-Free Cash Value Growth
2. Tax-Free Retirement Income
3. Peace of Mind For Your Family's Economic Security

The question you're probably asking yourself right now is, "*Why does the IRS give such preferential treatment towards life insurance Cash Value, and will they continue to do so in the future?*"

Well, life insurance was originally designed to protect widows that had lost their husbands (historically the primary bread winners of the family) and to protect kids who had lost their fathers to untimely deaths.

Life insurance, by design, is about *Love*.

You can roll your eyes at that comment all you want, but it's true. Life insurance was designed to ensure that if you died unexpectedly, you could economically provide for your family – the ones you love most – from the grave.

But with all noble causes, there are those people out there that attempt to abuse the system... and that's exactly what started happening in the 1970s.

People started designing life insurance contracts so that the majority of the premiums paid were going towards *Cash Value* accumulation, and very little was going towards the actual life insurance death benefit, exploiting a tax sheltered loophole in the IRS tax code.

Essentially, people were using life insurance policies as *investment-accounts-in-disguise* due to the tax-favored treatment.

In the 1980s, Congress figured out the loophole, and eventually passed the *Technical and Miscellaneous Revenue Act of 1988 (TAMRA)*.

This new law placed limits on the amount of premium that a policy owner could put towards *Cash Value* growth, while still receiving *FIFO (First-In/First-Out)* tax treatment upon pulling money out of the policy for retirement.

Today, policies that are designed with a disproportionate ratio of monies towards *Cash Value* versus the death benefit, are considered to be *Modified Endowment Contracts (MECs)*, which have serious tax implications.

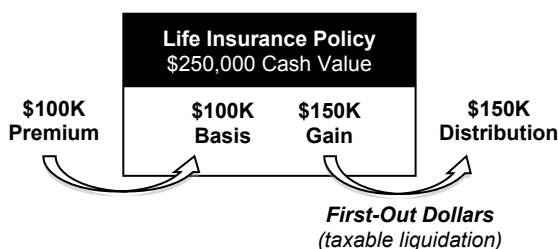
If a life insurance policy exceeds the MEC limit, the money taken out of the policy above *basis* becomes taxable.

Furthermore, for every dollar a policy owner takes from a MEC prior to age 59½, they will pay a 10% penalty for early withdrawal, whether those dollars are *distributions* or *policy loans*.

The tax treatment on MECs is referred to as *LIFO* (*Last-In/First-Out*).

The acronym *LIFO* is actually very misleading because the *Last-In* refers not to the *last dollars* you paid into the policy, but rather the *last dollars* gained within the policy (your interest / dividends / market gains / index gains).

Here's a diagram that illustrates this *LIFO* concept.



As a general rule of thumb, if you are going to use a permanent life insurance policy to supplement your retirement with a tax-free income stream, it is imperative that your policy NOT be a MEC.

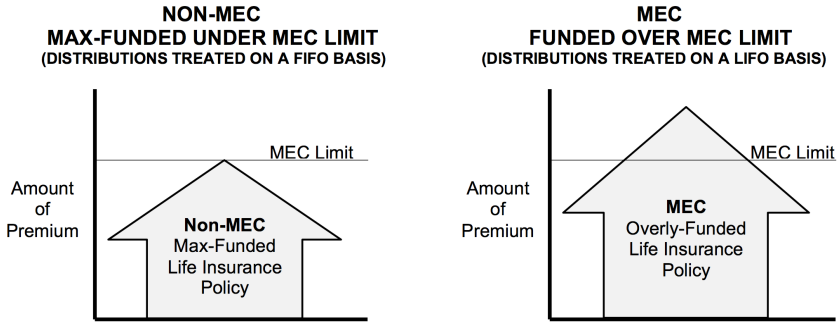
The last thing you want as you ease into retirement is to unexpectedly get hit with a huge phantom income tax bill, and that is what happens when your policy is designed in a way that exceeds the MEC limit.

Is your current life insurance policy designed to exceed the MEC limit? This is something that you need to find out immediately, because the longer you wait to find out, the greater your negative tax consequence will be.

Here's a graph that illustrates the concept of structuring a *Cash Value Life Insurance* policy to maximize *Cash Value* growth, without exceeding the MEC limit.

The example on the left is a non-MEC.

The example on the right is a MEC.



In rare circumstances where the policy owner **ONLY** wants the life insurance for the death benefit, and he or she is adamant about not needing an exit strategy, and doesn't want to take policy loans from the policy, sometimes a MEC can be a good solution, assuming the policy is designed to accumulate cash value for the sole purpose of buying *Paid-Up Additions* (in which case a certain type of Whole Life policy would be used).

In this scenario, the policy owner may feel the need to have the death benefit increase over time, and thus the *Cash Value* growth is used to buy incremental amounts of additional life insurance coverage, called *Paid-Up Additions*.

However, if this is **NOT** the case, MECs typically do not make sense from a tax perspective.

Here's something to think about for a moment.

The Federal Government puts a limit on how much you can pay into a life insurance contract for a specified amount of coverage.

Why?

Because the tax advantages of the tax-deferred *Cash Value* growth are substantial.

If you're looking to use your life insurance policy as a retirement income supplement, and you want to maximize your retirement income potential within your life insurance contract, *max-funding* your life insurance policy may be the strategy you'll want to go with.

What does *max-funding* mean?

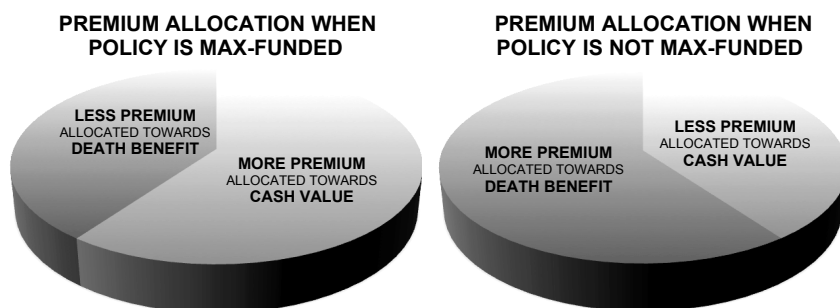


This means that the life insurance policy is designed to have the maximum amount of premium going into the policy, relative to the amount of coverage (to maximize *Cash Value* growth), and not to exceed the MEC limit.

When you *max-fund* an insurance contract, a greater percentage of the overall premium is going towards the Cash Value accumulation, and a smaller percentage is going towards buying more coverage, without exceeding the MEC limit.

Here are two pie charts that conceptually illustrate the difference between a *max-funded* life insurance policy, and a *non-max-funded* life insurance policy.

Notice the max-funded policy has more of the premium allocated towards the *Cash Value* than the *Death Benefit*, but is designed to NOT exceed the MEC limit.



The important thing is to understand what your options are, and to make sure you're entering the right strategy, using the right product – the right product for *you*.

Okay, so I got a little overly technical with the MEC limit stuff. But the reason I *went there* is that this is really the key to understanding how you can use life insurance, its tax-free *Cash Value* accumulation, and its tax-free policy loan provision, in order to design an incredible retirement strategy.

This is a big part of how you can *retire wealthy*.

Retiring *rich* is good... but retiring *wealthy* is better.

Let's talk about some of the details on how to do this properly... maximizing the preferential tax treatment the IRS gives life insurance policies and life insurance policy owners, as well as how to select the *right* life insurance agent.

*Ouch: How My Financial Advisor Lost Me \$930,000 In Three Years*

## Chapter Seven

### Selecting The Right Life Insurance Agent

Most people buy their life insurance policy from someone they know. Perhaps it is a friend or family member... or maybe a referral from a friend or family member... or maybe a referral from their CPA.

The logic behind this method of picking your life insurance agent is based on the assumption that if the agent is your friend, they wouldn't mislead you.

There's an element of trust involved.

But here's the problem, as well as the real danger.

Just because your insurance agent wouldn't intentionally take advantage of you from an *ethical* standpoint, they might unintentionally victimize you from an *incompetence* standpoint.

There are several core elements that must exist within a life insurance agent's abilities to truly serve you properly.

They must be ethical and put YOUR needs first.

That's obvious.

But they also must have certain skillsets, as well as resources, knowledge, abilities and access to the right products.

In this chapter, I will discuss the elements of these necessary attributes that an effective insurance agent must have, which include:

1. The ability to consult from an objective platform.
2. Extensive knowledge of *Carrier Underwriting Appetites*.
3. Comprehensive knowledge of *Table Shaving Programs*.

Without these attributes, an insurance agent cannot help you select the most beneficial life insurance product based on your unique circumstances.

In addition, it's important to develop a long-term relationship with an advisor that is going to be able to advise you in the many years to come.

Most life insurance agents make the bulk of their commissions within the first year of the policy being sold, which is why often times once the sales transaction is completed, the client never hears from the life insurance agent again.

This type of agent is solely focused on a single transaction, and a short-term benefit to themselves, which is pure selfishness and negligence on behalf of the life insurance agent.

Let's discuss the details of the necessary attributes a life insurance agent must have to serve your needs most effectively.

### **Consulting From An Objective Platform**

The majority of life insurance agents are what we call *Career Agents*. What this means is that they are contracted to exclusively sell insurance products from only ONE primary insurance carrier. They are contractually obligated to offer that ONE insurance carrier's product, first and foremost.

The problem this business model creates is that it makes it impossible for you, the client, to receive 100% objective, unbiased advice from the insurance agent. The agent is going to push one agenda – *their agenda* – regardless of what's right for you.

For example, there are some insurance companies that have great *Whole Life* products, but they do not have *Indexed* products in their product portfolios.

So let's say you're the type of client that should be in an *Indexed Universal Life* policy, but your insurance agent can ONLY sell *Whole Life* products.

Do you think they're going to be honest with you, and advise you to *not* buy from them, and suggest that you should work with an agent that sells *Indexed Universal Life* products?

I think you know the answer to that question.

So what happens in most cases?

The agent selfishly convinces you to buy a product that THEY represent, and because you're relying on them to advise you, you take their biased, self-serving advice.

Regarding the type of policy being purchased by the client, please understand that I'm not saying that *Indexed UL* is better than *Whole Life*, nor am I saying that *Whole Life* is better than *Indexed UL*.

My point however is that if you're going to purchase either one of these products, wouldn't you rather work with a life insurance agent that had the ability to offer you ALL available options rather than an agent that could only offer you ONE option?

Of course you would.

That's the only way to know for sure that your agent is giving you unbiased advice.

Virtually any sales person that can only offer you one company's product – *THEIR company's product* – is going to tell you all the reasons why you should buy from them, and how THEIR company's product is the best.

Clearly, this is heavily biased advice.

They are trying to *sell* and *convince* you, rather than objectively *advise* you (which is what you really need someone to do). By definition, they don't have your best interests in mind.

They have THEIR best interests in mind.

Just look at your insurance agent's business card. If their business card has an insurance carrier's logo on it (as opposed to an independent wealth management firm's logo), they're probably a *Career Agent*, and they will try to convince you that their company's product is the best.

Listen, NO one insurance carrier is the best fit for EVERY single client, in every single category. To say so is just plain stupid and ignorant.

I know my tone in discussing this issue may seem harsh, but the severity of being placed in the wrong life insurance

product, using the wrong financial strategy, can put you in a devastatingly adverse situation.

The only way to receive truly unbiased, objective advice is to work with an advisor that has independent broker contracts with multiple insurance carriers, with no personal bias towards any one insurance carrier, and no favorable financial benefit to themselves to push any one insurance carrier.

At my firm, we work with over fifty of the top life insurance companies in the nation, with no restrictions on what we can and can't offer clients.

The result of operating from this objective and unbiased platform is that our clients receive advice based on what's truly best for them, relative to their unique set of circumstances.

We don't *sell* product.

We objectively advise our clients after a thorough and in depth educational process of making sure they understand what all of their options are.

We then engage in an exploratory conversation regarding what their main objectives are, and then – and only then – will we make our recommendations regarding the appropriate life insurance product or combination of products that best suit them.

## **Understanding Carrier Underwriting Appetites**

*Underwriting* is the process that an insurance carrier goes through when evaluating a life insurance applicant. The underwriters evaluate a person's health by cross-referencing the applicant's health information on their application with their blood and urine lab results, along with their medical records provided by their healthcare professional, as well as the *MIB (Medical Information Bureau)*.

Every insurance carrier has a *sweet spot* regarding their client demographics. We call this sweet spot the carrier's *appetite*.

What this means is that depending on your unique set of health conditions and circumstances, specific insurance carriers

will be more welcoming (in terms of rates and acceptance), and others will be less forgiving (and will charge you a higher rate, or may even decline giving you coverage all together).

This is one of the main reasons why it's so important to work with a life insurance agent that:

1. Has the ability to place you with any carrier.
2. Has the knowledge of which insurance carrier is the best fit for your unique set of circumstances.
3. Has the integrity to help you make that decision, regardless of how it impacts them financially.

I once worked with a client that told me that he was sure we couldn't help him get additional life insurance coverage. He needed an additional \$3 million of permanent coverage to cover his daughter's future estate tax liability.

When I asked him why he thought he wouldn't qualify, he told me that his previous life insurance agent tried to get him that additional coverage, but he was declined due to the fact that he was diagnosed with sleep apnea.

I thought this was strange, because I know several insurance carriers that accept clients with sleep apnea.

To make a very long story short, I discovered that the previous agent only represented ONE life insurance carrier, and although that particular life insurance carrier was a reputable company, they didn't accept clients with sleep apnea as a matter of policy.

So the obvious question is, *"Why didn't the previous agent shop the market for this client and place him with an insurance carrier that accepts clients with sleep apnea?"*

The answer is simple.

The previous agent was contractually forbidden to do so. He was a *Career Agent / Captive Agent* with that insurance carrier.

Now, there are some *Career Agents / Captive Agents* out there that have the ability to contractually shop the market outside



their primary insurance carrier, but they're forced to do it through a brokerage arm of their primary insurance carrier, which pays them substantially less commission.

As a result of the lesser commission amount, the agent will often times either press their own selfish agenda onto the client in order to maximize their commissions, or if they've been drinking the insurance company's *Kool-Aid* long enough, they won't even consider the fact that there may be a better alternative choice for the client.

Again, it is an incredibly ignorant thing to say that any ONE insurance carrier is the best in ALL categories of life insurance. Any agent that says so is pushing their own agenda, instead of looking out for your best interests.

Regarding this particular client with sleep apnea, we were able to negotiate offers from two other life insurance companies that didn't have a problem with sleep apnea health conditions.

There are even some life insurance carriers that won't give you a rate increase even if you currently take high blood pressure medication, as long as your blood pressure lab results are acceptable (whereas some insurance carriers will give you a substantial rate increase).

The key is, you have to know which life insurance companies these are, and the only way you're going to know is by working with an insurance agent that has the resources, knowledge and integrity to do so. That's why the role of a life insurance advisor is so important.

The key is to be honest in the fact-finding session when you're filling out the health questionnaire with your agent, assuming you're working with an agent that:

1. Has the ability to place you with any carrier.
2. Has the knowledge of what insurance carrier is the best fit for your unique set of circumstances.
3. Has the integrity to help you make that decision, regardless of how it impacts them financially.

## Table Shaving Programs

Another huge advantage of working with an insurance agent that has access to all the major insurance carriers is that they can help you take advantage of certain promotional programs.

From time-to-time, some select insurance carriers will have *Table Shaving Programs*. What this means is that in an attempt to gain greater market share in any given year, some insurance companies will give you a better health rating than you would normally get.

Here's how this can impact you.

Each insurance carrier has their own tiered health rating system, but for the most part, they are very similar.

If a person is of average health, they'll receive a *Standard* health rating. If their health is above average, they can receive a *Better-Than-Standard* health rating, such as a *Preferred* rating or an *Ultra-Preferred* rating, which can lower the cost of insurance, substantially.

However, if a person's health is *Worse-Than-Standard*, they'll receive a *Table Rating*. There are usually several *Tables* (tiers of health ratings) worse than *Standard*.

For example, a *Table 1* rating would be one tier lower than *Standard*. Every time a person's health rating drops one *Table* level, their premium rate increases by approximately 25%.

So if a person receives a *Table 3* rating from an insurance carrier, they're going to pay approximately 75% more than they would if they were of average health and received a *Standard* health rating.

Ouch.

Depending on the size of the insurance policy, a 75% increase in cost can be incredibly significant.

That's why your insurance agent's knowledge of different insurance carriers' *Table Shaving Programs* can be so important.

This should be a major consideration when deciding on which insurance carrier to go with, and should be directed by your life insurance agent, assuming he or she:

1. Has the ability to place you with any carrier.
2. Has the knowledge of what insurance carrier is the best fit for your unique set of circumstances.
3. Has the integrity to help you make that decision, regardless of how it impacts them financially.

I realize I probably sound like a broken record, continually going back to these three attributes, but as you're beginning to discover through reading this book, there are some very important complexities that you **MUST** understand when purchasing a life insurance policy.

In addition, some insurance companies even have tobacco forgiveness programs where they'll give you a *Non-Smoker* rating if you promise to stop smoking within a certain number of years, which can dramatically impact your rate as well.

They'll check the lab results of your blood panel after those years have elapsed, and if you are tobacco-free at that point, you'll continue to enjoy the lower rate.

On top of that, some insurance companies rate the use of tobacco evenly across the board, whether it's cigarette usage or chewing tobacco usage, whereas with other insurance companies, the use of chewing tobacco doesn't affect the rate increase as harshly.

Obviously, if you don't chew tobacco, this is a non-issue, however if you *do* chew tobacco, working with a life insurance agent who knows how to help you navigate through the decision making process can prove to be invaluable from a cost-savings standpoint.

Here's an example of one of our clients that achieved a tremendous benefit by having us shop the market for a life insurance carrier that was the perfect fit for her, based on her health conditions.

The client was 81-years old, and had a net worth of approximately \$13 million.

Her estate (the family-owned business and their real estate holdings) was going to transfer to her children when she died (her husband was already deceased).

She was paying \$1.2 million per year for a policy that was placed with a very reputable life insurance carrier, however the problem was that she was given a Table 6 rating with this particular carrier.

Despite this client being one year older when we shopped the market for her (which would typically trigger a much higher insurance cost, especially because when a client is in this age bracket, the incremental costs increase substantially), we were able to find her an insurance carrier that was willing to issue her a *Standard* health rating.

This resulted in a 43% savings, resulting in a cost reduction of over \$514,000 per year. Over the course of five years, that generated a savings of over \$2.57 million dollars. Here's the comparison chart:

	<b>Old Policy</b>	<b>New Policy</b>
Amount of Coverage:	\$7 million	\$7 million
Health Rating:	Table 6	Standard
Annual Cost:	\$1.2 million	\$686,000
Age of Insured When Purchased:	Age 81	Age 82
Premium Savings @ Age 86:	N/A	\$2.57 million
Percentage of Savings:	N/A	43% Savings

## **The Reason Why I Wrote This Book**

At this stage in the book, you're probably wondering why I'm so adamant (and passionate) about working with the right life insurance agent.

The reason I wrote this book (and quite frankly, the reason I got into the life insurance industry) is due to the overwhelming lack of knowledge and understanding that most clients have regarding their own life insurance needs and policies.

It all started with my personal experience as a life insurance *client*.

I, like most life insurance clients, met my ex-life insurance agent through a mutual acquaintance. I trusted that he knew what he was doing, and I trusted that he had my best interests at heart.

At that time, I didn't know much about the different types of life insurance available, other than knowing that *Term* insurance was cheap and the coverage ended after 30 years, and that *Permanent* insurance was more expensive, but it lasted the duration of a person's life... so I thought.

Most people, I've found, have that same limited level of basic knowledge and understanding when it comes to life insurance.

I had heard of using life insurance as a way to build up some retirement income, but that's about the extent of what I knew about the concept. I was one of those guys that relied on my life insurance agent to take care of the details.

I trusted him.

He talked in circles, confusing the heck out of me, but he was a big hitter in the Newport Beach office of this *Fortune 100* company.

I figured he knew what he was doing.

To make a long story short, after pumping in over \$600,000 into this life insurance policy, I found out that it had *ZERO Cash Value* in it... *ZERO Surrender Value* in it... and that it was a *Traditional Universal Life* policy that was never designed to accumulate *Cash Value* (even though he led me to believe that it did).

Basically, I did not understand what product I bought, nor how it was designed to work. I, like most people, bought my life insurance policy based on blind faith that my agent was *helping* me. Obviously, the results proved otherwise.

He also misadvised me regarding an incomplete tax strategy, which cost me an additional \$330,000 in back taxes, IRS penalties and interest.

After the dust settled, including *hard dollar* and *soft dollar* losses, I figured that life insurance agent cost me over \$1 million in avoidable losses.

The sad thing is, I don't think he did it maliciously.

He was just one of those guys that generates his clients through referrals from his other ignorant clients who have no idea their life insurance policies are equally as screwed up.

By the time most of these clients find out what type of life insurance policies they *really* have, it will probably be too late, and they'll be stuck with an underperforming product that will suck them dry.

So why am I telling you all of these personal stories of the bad investments and ignorant purchases I've made over the years?

My hope is that you'll learn from my mistakes.

When I look back at my Hawaiian real estate investment, as well as my gargantuan life insurance policy that left me with nothing, these two mishaps were invaluable lessons for me, and hopefully they'll serve as invaluable lessons for you too.

I mean, there I was... a successful businessman... with multiple companies... highly-educated... intelligent... and, well, overly trusting when it came to putting my faith in these so-called *advisors*.

I thought to myself, "*If I got taken advantage of by incompetent advisors... and I'm a pretty smart guy... how many other intelligent, successful business owners out there are getting screwed by their life insurance agents, and have no idea it's happening to them right now?*"

That's what prompted me to start my own wealth management firm, specializing in rehabilitating my clients' financial/insurance situations and replacing the horrible life insurance policies that they unknowingly own.

*Ouch: How My Financial Advisor Lost Me \$930,000 In Three Years*

## Chapter Eight

# Is Your Life Insurance Policy Screwed Up?

I started my own wealth management firm primarily to undo the wrongful acts committed against life insurance clients.

There are certainly enough screwed up life insurance policies out there that need to be correctly replaced.

But for me, this is not just a business.

It's a PERSONAL MISSION.

I've estimated that of all the business owners my firm talks to (and we talk to thousands of them every week, all over the nation), about 95% of them don't really understand what kind of life insurance policy they have.

Of the 95% that don't understand what they have, once we educate them, explaining to them what they ACTUALLY have (and what the intention of the design of their life insurance policy is actually intended to do), about 90% of them discover they have the WRONG product.

Their life insurance policies are TOTALLY screwed up.

Now, you may be asking yourself, *"How could a successful business owner NOT understand his or her own life insurance policy?"*

Well, let me ask YOU the same question.

How much do you REALLY know about your current life insurance policy? Are you 100% sure your life insurance policy is:

1. Designed correctly?
2. Not going to lapse unexpectedly?
3. Not going to trigger phantom taxes?
4. Not violating IRS tax code?
5. Not going to increase in cost as you get older?
6. Insulated against down markets?
7. Maximizing *Cash Value* growth for retirement?



Most people (successful business owners included) don't really understand what kind of life insurance policy they have, nor do they understand how it works.

And most of them have life insurance policies that are totally screwed up.

Look at what happened to me.

And I assure you, I am not alone.

Seriously, over 90% of the life insurance policies I see are NOT what the client should really be in. I'm sure you're probably having a hard time believing this, but I assure you, I embellish this not one bit.

In this chapter, I will explain several reasons why this phenomenon is occurring, perhaps even to your policy, right now. The reality is, your current life insurance policy might be totally screwed up.

Let's find out why.

## **Wrong Policy Type**

As I discussed earlier, the majority of people that own life insurance policies don't fully understand what type of policy they have, what it was designed to do, nor how its *Cash Value* accumulation is currently performing (or underperforming).

I've personally talked to clients that owned *Whole Life* policies, and once I explained to them the difference between *Whole Life* and *Indexed Universal Life*, they preferred the *Indexed Universal Life* policy design over their *Whole Life* policy.

Conversely, I've talked to clients that owned *Traditional Universal Life* policies with practically zero *Cash Value* who came to realize they actually *thought* they owned *Whole Life* policies with guarantees and loads of *Cash Value*.

Even worse, I've talked to clients whose life insurance agents led them to believe they would have life insurance coverage until the day they died, only coming to find out that their policy was scheduled to lapse within just a few years.

I remember seeing one policy where the client was under the assumption that his life insurance policy was going to cover him until the day he died, regardless of what age that would be.

It was a *Permanent* policy (a *Traditional Universal Life* policy), and the way his life insurance agent positioned the policy to him at the time of purchase, led him to believe *Permanent* meant *lifetime coverage*.

Not always the case.

If the agent sold the life insurance policy under the assumption that the market would perform at an unrealistic level of performance, often times the policy would require additional funding in the future.

There are only four ways to fund an underperforming policy to keep it from lapsing:

1. Pay additional premiums.
2. Use the *Cash Value* of the policy to pay the additional premiums.
3. Reduce the life insurance amount.
4. Take an *RPU (Reduced Paid-Up)* policy.

In the case of the client I just mentioned (the one that thought his life insurance coverage would last him a lifetime), we told him to get us a copy of his policy to evaluate. This is part of our due diligence whenever we look at the potential of replacing a policy that could be underwater.

When we got a copy of his in-force illustration (a report of how his policy was performing), we found out his coverage was scheduled to lapse at age 73.

He had no idea.

Can you imagine if he turned 72 and realized that he couldn't afford to write the check for the necessary additional premium to keep the policy in force?

Or what if he died after he turned age 73?

What would happen to his family?

Fortunately, we found him in time to correct his unfortunate situation.

The new policy we designed for him cost him exactly the same amount of annual premium, but the difference was that instead of the policy lapsing at age 73, the new policy covered him until age 120.

Instead of him having to pay into the policy until age 73, we designed it so that he could stop paying into the policy at age 70.

But that's not all.

With the new policy, starting at age 71, he'll be able to start pulling out \$172,710 per year... every year... for 20 years. That's over \$3.45 million in total retirement income, all tax-free.

Here's the comparison between his old life insurance policy and the new one we replaced it with:

	<b>Old Policy</b>	<b>NEW Policy</b>
Amount of Coverage:	\$2 million	\$2 million
Annual Cost:	\$10,862	\$10,862
Last Payment Due:	Age 72	Age 70
Coverage Ends:	Age 73	At Death
Annual Retirement Income (Age 71-90):	\$0	\$172,710 per year
Total Retirement Income Generated:	\$0	\$3.45 million

If we compare this new and improved option with his old policy that was scheduled to lapse at age 73, it was a no-brainer for him to replace his old, underperforming policy.

So how was this possible?

Perhaps you're assuming that this client wasn't very smart or educated to have initially fallen for such an inferior product.

Wrong. He was a very intelligent and talented attorney.

So how could he have been sold such an inferior product?

The reason these types of situations exist so rampantly is that so many *Traditional Universal Life* policies were sold during a time when interest rates were in the 13% range.

Back then, a 13% current assumption was not out of the realm of possibility.

In fact, it was the norm.

However, the problem is that these very same policies that were designed to stay in force relying on a 13% rate of return are only experiencing around an 8% return, which is why they're scheduled to lapse... and this is why the aforementioned client's policy was scheduled to lapse.

To clarify some *industry terminology*, a policy staying *in force* simply means that the policy is staying alive, ensuring coverage. When a policy *lapses*, that simply means that the insurance coverage has come to an end (no more coverage) and the *Cash Value / Surrender Value* becomes zero. In other words, the policy goes *poof*... and it's gone forever.

In some fortunate cases, we'll find clients that have underperforming policies, however their policies have some *Surrender Value* left in them.

In such cases, we'll often *1035* the policy *Surrender Value* into a better, more appropriate policy.

## **The 1035 Exchange Strategy**

Section 1035 of the Internal Revenue Code allows the exchange of one life insurance policy for another, including the transfer of *Cash Value* from one policy to another, without any tax consequence on any *Cash Value* gains.<sup>6</sup>

When we find that a client has *Cash Value* in their current policy (assuming it's the inappropriate policy and should be replaced), and we help them execute a *1035 exchange*, often times the *Cash Value* transfer will be used to pay the first year's premium of the new policy as well.

But perhaps the biggest reason my firm does so many 1035 exchanges revolves around a law that was passed in 2009 that has revolutionized the life insurance industry.

This law has enabled talented life insurance agents to save their clients over 20% on their life insurance costs, as well as build more appropriate life insurance policies for their clients.

Let's discuss this 2009 law and how it may very well impact you in a positive way.

## 2001 CSO Rate Table

Life insurance companies base their cost of insurance on *mortality tables*. Mortality tables are statistical probability formulas that indicate how long the average person is expected to live.

In layman's terms, think of it like a bunch of really smart *data geeks* that lock themselves in a dungeon, analyzing death rates, survival expectancy, and a bunch of really technical statistics and data.

In the life insurance industry, these *data geeks* establish a formal industry-standard report called a *CSO Table*, which is an acronym for *Commissioner's Standard Ordinary* mortality table.

As of 2013, the most recent *CSO Table* was established back in 2001. However the previous *CSO Table* was established in 1980. That's a twenty-one year span between updating the *CSO Table*.

What the 2001 report found was that American women were living four years longer than they were in 1980, and American men were living three years longer.

The result: The cost of most life insurance policies should have dropped 20% - 40%. However, it did not.

The reason was due to the fact that there was no law that forced life insurance companies to start using the new, updated 2001 *CSO Table*. These insurance companies continued to use the 1980 *CSO Table*. But in 2009, everything changed.

In 2009, a law was passed that mandated that all life insurance companies had to start rating the cost of their life insurance products based on the new 2001 *CSO Table*.

We've had clients save as much as 43% on their policy cost by replacing their old life insurance policies they purchased prior to 2009 with new, updated ones... ones that were rated based on the 2001 *CSO Table*.

This new law did not retroactively affect any in-force policies. It only applied to new policies with effective dates post 2009.

When I discovered this, I saw an opportunity to help a giant segment of the population, specifically business owners that already had life insurance policies. They were paying substantially high premiums, and didn't realize they could replace them with a better option.

This CSO phenomenon created a situation in which a population of life insurance policy owners had outdated life insurance policies. They were overpaying for their life insurance by as much as 43%.

I immediately started doing my own research, and found that according to the *California Department Of Insurance*, between the years of 2004-2008, Californians spent over \$68.1 billion on life insurance premiums.

That's RIGHT! In that five-year period, JUST in the State of California, consumers spent over \$68.1 billion in life insurance premiums. To put that number in perspective, \$0.1 billion is \$100 million. Now that's a big number.

The point of me telling you this is to help you put into perspective just how many people exist out there that need to replace their life insurance policies. They're currently overpaying for an underperforming product, and they have no idea.

That's why I'm so passionate about what I do. When I finally discovered how screwed up my own life insurance policy was, I became obsessed with teaching other people how important it was to understand how their life insurance policies REALLY worked.

If I found out they were in the wrong type of policy, with the wrong insurance carrier, using the wrong strategy... well, let's just say I didn't pull any punches.

They say the truth shall set you free, and this truth – the truth about underperforming life insurance policies, as well as underperforming life insurance agents – has become a truth that I cannot keep quiet about.

So what's my point?

My point is, if you have a life insurance policy, and you purchased it prior to the most recently updated *CSO Table* mandate, you're probably overpaying for it.

At the very least, you should have your life insurance policy reviewed on an ongoing basis, to make sure that you're in the best situation possible at any given time.

The reality is that most life insurance agents make the bulk of their commissions up front, within the first year of the life insurance sale, which is why they're never to be heard from again.

In my humble opinion, this is negligence.

At my firm, I teach all of my agents and advisors to constantly communicate with their clients, doing annual policy reviews, and informing their clients of new concepts, products and strategies that have hit the market on an ongoing basis.

I take this profession very seriously.

At the expense of sounding morbid, after the terrorist attacks of 9/11, one of the most important phone calls the families of the deceased had to make the morning of 9/12 was to their loved one's life insurance agent.

Bills were still due.

Mortgages still needed to be paid.

Diapers still needed to be purchased.

For many families that lost their loved ones in 9/11, had it not been for the life insurance death benefit proceeds, they would have found themselves in financial ruin. This brings us back to the concept of *love*, which I will elaborate on in Chapter 11.

As you can see, life insurance can be used for more than one purpose. In the next chapter, we'll summarize the three main purposes of life insurance.

## Chapter Nine

# The Self-Completing Plan

Life insurance can be used as a tool to accomplish what we call a *Self-Completing Plan*. Remember those lucky sons-of-guns I talked about in the beginning of this book?

You know, the ones that are retiring wealthy, with tax-free income, that seem to have found a way to beat the system?

Well, what they have done accomplishes three main objectives, giving them peace of mind, financial freedom, and the ability to leave behind a legacy for their family.

They've accomplished:

1. A Tax-Free Retirement Income Stream.
2. Protection in The Event of a Disability.
3. Protection in The Event of an Unexpected Death.

Let's discuss each of these three great components of what we call *The Self-Completing Plan*.

### **Component #1: The Tax-Free Retirement Income**

Obviously, the primary purpose of life insurance is to protect your family with the death benefit, just in case something bad happens.

However, there are a lot of people, just like you, that are using life insurance to accumulate *Cash Value* to be later used to supplement their retirement with tax-free retirement income.

As we have discussed throughout the book, there are several different types of life insurance policies you can use to accomplish this outcome.

*Whole Life* can be a great option for people that tend to be a bit more conservative, and who like guarantees.



*Indexed Universal Life* can be a great option for people who want to participate in the growth potential of the S&P 500 (or other indices they may prefer over the S&P 500), while also having a *protective floor*.

*Variable Universal Life* can be a great option for people who want to actively manage their portfolio (such as Mutual Funds) inside their life insurance policy.

*Traditional Universal Life* can be a great fit for people who just want a permanent death benefit and don't care about *Cash Value* accumulation for retirement.

The key is to find an extremely knowledgeable and talented life insurance agent that can help you navigate through all of your conceptual options, and then be able to deliver the right product to you from the right insurance carrier, based on your unique set of circumstances.

Some people that have significant cash flow have decided to load up large life insurance policies (as large as their cash flow allows) with the intention of maximizing their *Cash Value* accumulation.

We've had tons of clients that have accomplished tax-free 6-figure retirement incomes by utilizing our strategies, most of them involving *Cash Value* life insurance policies as a means to accomplish this.

## **Component #2: Protection in The Event of a Disability**

In 2009, the Social Security Administration published a Fact Sheet that disclosed that statistically, one out of every three Americans become disabled before age 67.

1 out of 3!

That number is staggeringly high.

The challenge that a major disability presents is not just the inability to work and earn an income, but also the inability to continue to fund your retirement vehicle.

For many of our life insurance clients, we'll recommend that when they buy a life insurance policy, they should include a *Waiver Of Premium Rider*. The cost of doing so is nominal, but the protection is phenomenal.

What the *Waiver Of Premium Rider* provides in the event of a disability is assurance that the insurance carrier will continue to fund your life insurance policy at no additional cost to you.

Plus, your *Cash Value* accumulation is not adversely affected because the life insurance carrier literally pays the premiums for you, not only *waiving* the required premium payments, but they also pay the premiums into your policy for you.

What this accomplishes for you is that your *Cash Value* growth accumulates at the same rate as if you were actually making payments yourself.

Think of this concept as having insurance on your insurance. This simple yet powerful rider can be a game changer for you down the road in the unfortunate situation of you becoming disabled.

### **Component #3: Protection in The Event of Death**

One thing's for sure. We're all going to die someday.

As I mentioned at the very beginning of this book, some people say that life insurance is the one thing you buy, hoping you get screwed... because if you get your money's worth, it means you're dead.

Well, with term insurance, I would somewhat agree with that tongue-in-cheek statement... however with the proper permanent life insurance policy, nothing could be further from the truth.

The *living benefit* of tax-free *Cash Value* accumulation is a huge benefit, making life insurance one of the last tax-favored retirement vehicles.

Using life insurance to partially fund your retirement can be one of the best things you can do for yourself.

But the main reason you buy life insurance is to protect your family and your heirs. Dollar for dollar, pound for pound, there's no better way to pass on a financial benefit to your loved ones than a life insurance death benefit.

Many business owners will say that they plan to pass their company on to their family when they die, which is great.

Others will say they plan to pass on their real estate holdings to their family when they die, and I think that's great too.

But with a business and real estate, someone still has to actively manage them, and if your family sells the business or the real estate because they need the cash, they'll face a tax liability.

But when you pass your life insurance death benefit onto your family, they receive it tax-free.

But best of all, they'll receive that amount in cash, unencumbered, and in one lump sum.

I'm probably a bit hypersensitive when it comes to this subject because I've seen what happens to a family that isn't protected with the proper life insurance. In fact, I saw it in my own family.

I was 19-years old, and a sophomore in college.

One Sunday morning, I was in my apartment, and the phone rang. It was my cousin Leslie.

She asked me, *"Have you heard about cousin Nick yet?"*

*"Umm, no. What are you talking about?"* I inquired.

She replied, *"Nick just got diagnosed with leukemia."*

I didn't know much about what leukemia entailed back then, but I knew it was serious.

My cousin Nick was a dynamic individual. He was only 33-years old at that time. He spoke seven different languages, lived in St. Paul, Missouri with his wife and two kids, and did a considerable amount of business in South America.

Nick's master plan was to retire at age 40.

Needless to say, he was ambitious, very talented, and very successful in his career.

He thought he was bulletproof.

And he didn't believe in life insurance.

Nine months later, he was dead.

He had built a great life for his family. They had the big house with the proverbial white picket fence.

Housekeeper.

Nanny.

The works.

But when he died, their household income plummeted. Nick was the primary breadwinner of the family, and the lifestyle his family had become accustomed to living was based on his substantial income.

The family's income went from two incomes down to one income – one substantially lower income.

His daughter, Nicole, was only 4-years old at the time. His son Alexander was only 2-years old.

Imagine what would happen to your family if you died tomorrow.

Would your family be able to pay the mortgage?

Would they be able to survive without your income?

If so, how many months could they go on, paying the bills, without your income?

So many people say, *"Yeah, but that's not gonna happen to me. I'm healthy."*

Okay, let's assume you're healthy, and you come from a long bloodline of healthy ancestors.

Well, car accidents don't care about your bloodline.

If you're running a business, you're under a lot more stress than the average person, which puts you at a greater risk for heart attacks and strokes.

The point is, we never know when our time on this planet is up. It may sound morbid to say, but it's true.

Okay, enough talk about *death*.

Let's talk about the subject of *life* and how you can generate a *6-Figure Retirement Income*.

## Chapter Ten

### The 6-Figure Retirement Income

So how do you create a *6-Figure Retirement Income* using a life insurance policy?

And how do you receive that income tax-free?

Well, as discussed repeatedly in this book, each individual person will experience different cash-in/cash-out numbers based on their age, health rating, number of years funding the policy, the insurance carrier used, and a number of other factors.

But I thought I'd share with you a case study of how this works.

#### **The 6-Figure Retirement Income Case Study**

Keep in mind, this is only one example of a client using an *Indexed UL* policy based on an 8% current assumption internal rate of return. This client was a 40-year old male, and the numbers I'll illustrate here are based on him receiving a *Standard* health rating. Your personal results will vary based on the variables we just discussed.

This example is illustrating \$15,484 in premium going into the policy per year, which gave the client \$1 million of coverage. For someone making \$150,000 per year, that's only 10% of his or her annual income... about \$1,290 per month.

The table on the next page will show him doing that for 30 years, and after the 30<sup>th</sup> year, his life insurance would have actually increased to over \$1.7 million dollars in life insurance coverage.

He has also accumulated over \$1.4 million in *Cash Value* after 30 years. So his total cash outlay (insurance premium payments) totals \$464,520, which was paid over the course of those 30 years.

His \$464,520 cash-in... has grown to \$1,482,564.

Not too shabby.

Again, he's got \$1,719,774 of life insurance coverage at that point.

Here's an abbreviated illustration of the first 30 years of this client's life insurance example.

<b>Policy Year</b>	<b>Age</b>	<b>Premium Outlay</b>	<b>Retirement Income</b>	<b>Cash Value</b>	<b>Death Benefit</b>
1	40	\$15,484	\$0	\$0	\$1,000,000
2	41	\$15,484	\$0	\$11,226	\$1,000,000
3	42	\$15,484	\$0	\$22,090	\$1,000,000
4	43	\$15,484	\$0	\$34,503	\$1,000,000
5	44	\$15,484	\$0	\$48,607	\$1,000,000
6	45	\$15,484	\$0	\$64,195	\$1,000,000
7	46	\$15,484	\$0	\$81,393	\$1,000,000
8	47	\$15,484	\$0	\$100,323	\$1,000,000
9	48	\$15,484	\$0	\$121,618	\$1,000,000
10	49	\$15,484	\$0	\$144,578	\$1,000,000
11	50	\$15,484	\$0	\$171,889	\$1,000,000
12	51	\$15,484	\$0	\$201,645	\$1,000,000
13	52	\$15,484	\$0	\$234,092	\$1,000,000
14	53	\$15,484	\$0	\$269,266	\$1,000,000
15	54	\$15,484	\$0	\$307,416	\$1,000,000
16	55	\$15,484	\$0	\$348,709	\$1,000,000
17	56	\$15,484	\$0	\$393,485	\$1,000,000
18	57	\$15,484	\$0	\$442,055	\$1,000,000
19	58	\$15,484	\$0	\$494,761	\$1,000,000
20	59	\$15,484	\$0	\$551,978	\$1,000,000
21	60	\$15,484	\$0	\$614,147	\$1,000,000
22	61	\$15,484	\$0	\$681,745	\$1,000,000
23	62	\$15,484	\$0	\$755,317	\$1,000,000
24	63	\$15,484	\$0	\$835,478	\$1,035,993
25	64	\$15,484	\$0	\$922,714	\$1,125,711
26	65	\$15,484	\$0	\$1,017,357	\$1,220,829
27	66	\$15,484	\$0	\$1,119,980	\$1,332,776
28	67	\$15,484	\$0	\$1,231,239	\$1,452,862
29	68	\$15,484	\$0	\$1,351,844	\$1,581,658
30	69	\$15,484	\$0	\$1,482,564	\$1,719,774

Starting at age 70, he'd STOP paying into the policy, and start pulling \$136,406 per year out of the policy, tax-free, EVERY YEAR, from age 70 all the way to age 89.

Here's the abbreviated illustration of the policy for years 31 through 60 (age 70-99)... zero premium payments, plus a tax-free 6-figure retirement income.

Policy Year	Age	Premium Outlay	Retirement Income	Cash Value	Death Benefit
31	70	\$0	\$136,406	\$1,456,094	\$1,674,509
32	71	\$0	\$136,406	\$1,427,677	\$1,613,275
33	72	\$0	\$136,406	\$1,397,212	\$1,550,905
34	73	\$0	\$136,406	\$1,364,550	\$1,494,714
35	74	\$0	\$136,406	\$1,329,455	\$1,438,031
36	75	\$0	\$136,406	\$1,291,857	\$1,374,683
37	76	\$0	\$136,406	\$1,250,978	\$1,339,074
38	77	\$0	\$136,406	\$1,206,514	\$1,299,866
39	78	\$0	\$136,406	\$1,158,135	\$1,256,714
40	79	\$0	\$136,406	\$1,105,496	\$1,209,262
41	80	\$0	\$136,406	\$1,048,190	\$1,157,085
42	81	\$0	\$136,406	\$985,779	\$1,099,728
43	82	\$0	\$136,406	\$917,787	\$1,036,694
44	83	\$0	\$136,406	\$843,686	\$967,434
45	84	\$0	\$136,406	\$762,898	\$891,346
46	85	\$0	\$136,406	\$674,771	\$807,748
47	86	\$0	\$136,406	\$578,609	\$715,914
48	87	\$0	\$136,406	\$473,630	\$615,028
49	88	\$0	\$136,406	\$358,976	\$504,193
50	89	\$0	\$136,406	\$233,718	\$382,439
51	90	\$0	\$0	\$239,314	\$391,398
52	91	\$0	\$0	\$246,613	\$371,094
53	92	\$0	\$0	\$256,362	\$351,950
54	93	\$0	\$0	\$269,520	\$334,827
55	94	\$0	\$0	\$287,270	\$320,775
56	95	\$0	\$0	\$306,048	\$340,430
57	96	\$0	\$0	\$325,864	\$361,149
58	97	\$0	\$0	\$346,796	\$383,010
59	98	\$0	\$0	\$368,822	\$405,994
60	99	\$0	\$0	\$391,940	\$430,096

And at age 90, he'd still have \$391,398 of life insurance.

Remember, he stopped paying into the policy 20 years ago.

So again, over the first 30 years, he paid \$15,484 per year into the policy, which is \$464,520 going in, but for the next 20 years, he's pulling out \$136,406 per year, EVERY YEAR, totaling



over \$2.7 million. That's a gain of over \$2.2 million, tax-free. That's the *6-Figure Tax-Free Retirement Income* we've been talking about.

In addition, this life insurance policy will give him coverage until age 120, and his *Cash Value* actually starts to increase again, starting at age 90, and continues until age 120. Here's an abbreviated illustration that shows the *Cash Value* increase, as well as the insurance coverage increase.

Policy Year	Age	Premium Outlay	Retirement Income	Cash Value	Death Benefit
61	100	\$0	\$0	\$416,080	\$455,248
62	101	\$0	\$0	\$441,081	\$481,287
63	102	\$0	\$0	\$466,799	\$508,067
64	103	\$0	\$0	\$493,070	\$535,425
65	104	\$0	\$0	\$519,672	\$563,135
66	105	\$0	\$0	\$546,454	\$591,046
67	106	\$0	\$0	\$573,280	\$619,020
68	107	\$0	\$0	\$600,029	\$646,936
69	108	\$0	\$0	\$626,610	\$674,704
70	109	\$0	\$0	\$653,037	\$702,336
71	110	\$0	\$0	\$679,510	\$730,037
72	111	\$0	\$0	\$705,957	\$757,732
73	112	\$0	\$0	\$732,253	\$785,297
74	113	\$0	\$0	\$759,915	\$814,264
75	114	\$0	\$0	\$789,032	\$844,724
76	115	\$0	\$0	\$819,699	\$876,773
77	116	\$0	\$0	\$852,017	\$910,514
78	117	\$0	\$0	\$886,093	\$946,056
79	118	\$0	\$0	\$922,046	\$983,517
80	119	\$0	\$0	\$959,998	\$1,023,025
81	120	\$0	\$0	\$1,000,084	\$1,064,713

Again, in this example, we used a 40-year old male with a *Standard* health rating. Your age, gender, and health rating may be different. So to determine *your* actual results, you should find a qualified financial advisor or life insurance agent that specializes in the retirement strategies we've been discussing.

The process would involve giving the person a copy of your current life insurance policy and have them design a strategy that's custom-tailored to fit your specific needs.

## Chapter 11

### The Real Truth

Up until this point, you probably think I am trying to convince you that Indexed Universal Life Insurance is the best thing since sliced bread.

The blunt truth is that it's not right for *everyone*.

If the person's health and medical history have challenges, sometimes the numbers may not work to his or her advantage due to the disproportionate amount of premium that would be required to pay for the disproportionately high cost of insurance.

In every scenario, you have to run the numbers side-by-side including the eroding factors like fees, taxes, risk, time horizon, etc., and just let the math tell you whether or not it's a good option.

Perhaps the most important thing for you to take away from this book is that my opinions on this topic are absolutely irrelevant.

Whether or not you like the idea of using a life insurance policy to partially fund your retirement is also irrelevant.

The **ONLY** thing that matters is the math.

The math will tell you whether it's a good deal or not... and if it's not, then I'd say don't do it.

If the math tells you it **IS** a good deal, then I'd say you ought to do it.

Simple, right?

Remember when I walked you through the *true math* I did on my waterfront vacation pad in Hawaii?

It's absolutely shocking.

The simple math makes that Hawaii real estate investment look great. Buy the property for \$515,000... sell it for \$1 million... gross a total of \$720,000 in rental income over 20 years

(\$36,000 per year for 20 years)... and stay there whenever I want *for free* since I own it.

Sounds good, right?

Again, the *real math* shows a projected total loss of \$435,909.70 over the 20-year period.

To put that into perspective, think about how many luxury vacations I could have taken for \$425,909.70.

Geez.

I'm telling you, had I known the *real math* when I first bought that place back in 2005, I wouldn't have bought it.

I would have dumped that money into an *Indexed Universal Life Insurance* policy and let it accumulate tax-deferred over those years, and at retirement, start drawing out a nice healthy tax-free retirement income.

You can revert back to *Page 28* to take a look at the math on my Hawaii vacation home again if you like.

My pain, your gain.

I've chalked up my Hawaii pad to being a *really cool and very expensive* vacation home, but as far as an *investment*, it's awful.

Again, nobody showed me the *real math*.

A similar phenomenon happens in non-real estate investments as well.

Take the life insurance industry for example.

Have you ever had a financial advisor show you the *real math* in terms of using an *Indexed Universal Life Insurance* policy as an asset class compared to buying *Term Life Insurance* and investing the difference in a traditional investment like a mutual fund?

Now, when I say THE REAL MATH, I'm talking about showing you a detailed ledger that includes all the details, similar to what I did on *Page 28* with my Hawaii vacation home. I'm guessing the answer is no. Allow me to show you the *real truth*.

## Buy Term & Invest The Difference

There are a few people out there that question whether or not life insurance is a good *investment*. Suze Orman and Dave Ramsey are two of the most well known TV/Radio celebrities that denounce using cash value life insurance policies as retirement vehicles.

They'll tell you to buy term insurance and invest the difference in the market.

Now, I'm not here to bash anyone's opinion, but let's just do the math, because the math doesn't lie.

Let's compare what happens when you use an indexed universal life insurance policy as a retirement supplement, versus buying a 30-year TERM life insurance policy and investing the difference in the market, and we'll let the MATH tell us the REAL truth.

For the purpose of this example, we'll use a 43-year old male and we'll assume he needs \$1,000,000 of life insurance coverage.

We're going to use an annual budget of \$17,830. To put that number into perspective, the maximum allowable 401(k) annual contribution is \$18,000 per year for someone making under \$120,000 per year.

I'm also going to assume this hypothetical client has an annual household income between \$250,000 - \$400,000, so the \$17,830 annual contribution is realistically affordable relative to his household income.

In this example, we'll show \$17,830 per year going into the Indexed Universal Life Insurance policy, versus this same client buying a \$1,000,000 30-Year Term life insurance policy (the annual premium is only \$1,522) and investing the \$16,308 difference in the market.

\$1,522	Annual 30-Year Term Insurance Premium
+ \$16,308	Investing This Difference In The Market
<b>\$17,830</b>	<b>Total Annual Outlay (same amount going into the IUL)</b>

We'll also assume the same 7.50% rate of return in both the Indexed Universal Life Insurance policy, as well as in this investment account.

Let's start off by looking at the *Buy Term & Invest The Difference* model.

Don't let this ledger below intimidate you. I'll walk you through it step by step, because remember, the math is all that matters. I want to make sure you understand the *real* math.

1	2	3	4	5	6	7	8
YEAR	AGE	30-YEAR TERM PREMIUM	ANNUAL INVESTMENT CONTRIBUTION	INVESTMENT FUND CAGR	AFTER TAXES & FEES NET CAGR	CUMULATIVE INVESTMENT ACCOUNT BALANCE	30-YEAR TERM DEATH BENEFIT
1	43	\$1,522.00	\$16,308.00	7.50%	2.61%	\$16,734.32	\$1,000,000.00
2	44	\$1,522.00	\$16,308.00	7.50%	2.61%	\$33,479.78	\$1,000,000.00
3	45	\$1,522.00	\$16,308.00	7.50%	2.61%	\$50,662.99	\$1,000,000.00
4	46	\$1,522.00	\$16,308.00	7.50%	2.61%	\$68,295.39	\$1,000,000.00
5	47	\$1,522.00	\$16,308.00	7.50%	2.61%	\$86,388.74	\$1,000,000.00
6	48	\$1,522.00	\$16,308.00	7.50%	2.61%	\$104,955.07	\$1,000,000.00
7	49	\$1,522.00	\$16,308.00	7.50%	2.61%	\$124,006.75	\$1,000,000.00
8	50	\$1,522.00	\$16,308.00	7.50%	2.61%	\$143,556.47	\$1,000,000.00
9	51	\$1,522.00	\$16,308.00	7.50%	2.61%	\$163,617.26	\$1,000,000.00
10	52	\$1,522.00	\$16,308.00	7.50%	2.61%	\$184,202.46	\$1,000,000.00
11	53	\$1,522.00	\$16,308.00	7.50%	2.61%	\$205,325.78	\$1,000,000.00
12	54	\$1,522.00	\$16,308.00	7.50%	2.61%	\$227,001.31	\$1,000,000.00
13	55	\$1,522.00	\$16,308.00	7.50%	2.61%	\$249,243.46	\$1,000,000.00
14	56	\$1,522.00	\$16,308.00	7.50%	2.61%	\$272,067.06	\$1,000,000.00
15	57	\$1,522.00	\$16,308.00	7.50%	2.61%	\$295,487.30	\$1,000,000.00
16	58	\$1,522.00	\$16,308.00	7.50%	2.61%	\$319,519.78	\$1,000,000.00
17	59	\$1,522.00	\$16,308.00	7.50%	2.61%	\$344,180.51	\$1,000,000.00
18	60	\$1,522.00	\$16,308.00	7.50%	2.61%	\$369,485.91	\$1,000,000.00
19	61	\$1,522.00	\$16,308.00	7.50%	2.61%	\$395,452.82	\$1,000,000.00
20	62	\$1,522.00	\$16,308.00	7.50%	2.61%	\$422,098.55	\$1,000,000.00
21	63	\$1,522.00	\$16,308.00	7.50%	2.61%	\$449,440.84	\$1,000,000.00
22	64	\$1,522.00	\$16,308.00	7.50%	2.61%	\$477,497.90	\$1,000,000.00
23	65	\$1,522.00	\$16,308.00	7.50%	2.61%	\$506,288.41	\$1,000,000.00
24	66	\$1,522.00	\$16,308.00	7.50%	2.61%	\$535,831.55	\$1,000,000.00
25	67	\$1,522.00	\$16,308.00	7.50%	2.61%	\$566,146.99	\$1,000,000.00
26	68	\$1,522.00	\$16,308.00	7.50%	2.61%	\$597,254.92	\$1,000,000.00
27	69	\$1,522.00	\$16,308.00	7.50%	2.61%	\$629,176.06	\$1,000,000.00
28	70	\$1,522.00	\$16,308.00	7.50%	2.61%	\$661,931.67	\$1,000,000.00
29	71	\$1,522.00	\$16,308.00	7.50%	2.61%	\$695,543.55	\$1,000,000.00
30	72	\$1,522.00	\$16,308.00	7.50%	2.61%	\$730,034.10	\$1,000,000.00
31	73	\$0.00	\$17,830.00	7.50%	2.61%	\$766,948.29	\$0.00

In column 3, we see the cost of the 30-year term insurance premium at \$1,522. In column 4, we see the difference of \$16,308 being invested in a traditional investment account like a mutual fund for example. Remember, the client's going to pay investment fees in the traditional investment of approximately 2.65%.

In addition, we're assuming he's married filing jointly in the state of California, and his household income is between \$250,000 - \$400,000 per year. At that income level he'd pay 33.00% in Federal tax, 9.30% in California State Tax, and 3.80% in Medicare tax, totaling 46.10% in short-term capital gains tax on his investment gains.

Let's do the math on this.

7.50%	Gross Investment Return
- 2.65%	Investment Fees
<b>4.85%</b>	<b>Return After Investment Fees</b>
- 46.10%	Short-Term Capital Gains Tax Rate On Investment Gains
<b>2.61%</b>	<b>Net Gain After Fees &amp; Taxes</b>

Do you see that? The 7.50% return just plummeted to only 2.61% after investment fees and taxes (which we see in column 6).

In column 7, we see the account balance of the investment fund growing at this *after fees and taxes* compounded annual growth rate of 2.61%. At age 73 (in year 31), his 30-year term life insurance policy has expired, and his investment account has grown to \$766,948.29.

So that's the math on the *Buy Term & Invest The Difference* model. Now let's look at the Indexed Universal Life Insurance model and once again, we'll do the math.

In this scenario, we're going to put the full \$17,830 annual contribution towards the Indexed Universal Life Insurance policy in the form of *premium*.

We're also going to assume the same 7.50% return that we used in the *Buy Term & Invest The Difference* model.

In the *Indexed Universal Life Insurance* policy below, we see the full \$17,830 annual contribution going in as premium (in

column 3) growing at a 7.50% internal rate of return. For the record, this is a very conservative rate of return for this product. In the last ten years (between 2006-2015), Pacific Life's *Indexed Universal Life Insurance* cash value has yielded an 8.58% return.

Obviously, there is a cost of insurance (100% of the premium does not all apply to the cash value), thus the 7.50% number we're using in this example only applies to the internal rate of return of the cash value growth. In this particular policy, factoring in the cost of insurance takes the total dollars-in versus dollars-out compounded annual growth rate down to 6.21% (in column 5).

1	2	3	4	5	6	7
YEAR	AGE	IUL ANNUAL PREMIUM	CASH VALUE INTERNAL RATE OF RETURN (CAGR)	PREMIUM DOLLARS-IN DOLLARS-OUT CAGR	CASH VALUE IN IUL POLICY BASED ON 7.50% CAGR	IUL POLICY DEATH BENEFIT
1	43	\$17,830.00	7.50%	6.21%	\$0.00	\$1,000,000.00
2	44	\$17,830.00	7.50%	6.21%	\$13,295.00	\$1,000,000.00
3	45	\$17,830.00	7.50%	6.21%	\$26,008.00	\$1,000,000.00
4	46	\$17,830.00	7.50%	6.21%	\$40,477.00	\$1,000,000.00
5	47	\$17,830.00	7.50%	6.21%	\$56,867.00	\$1,000,000.00
6	48	\$17,830.00	7.50%	6.21%	\$74,923.00	\$1,000,000.00
7	49	\$17,830.00	7.50%	6.21%	\$94,787.00	\$1,000,000.00
8	50	\$17,830.00	7.50%	6.21%	\$116,607.00	\$1,000,000.00
9	51	\$17,830.00	7.50%	6.21%	\$141,089.00	\$1,000,000.00
10	52	\$17,830.00	7.50%	6.21%	\$167,418.00	\$1,000,000.00
11	53	\$17,830.00	7.50%	6.21%	\$198,771.00	\$1,000,000.00
12	54	\$17,830.00	7.50%	6.21%	\$232,596.00	\$1,000,000.00
13	55	\$17,830.00	7.50%	6.21%	\$269,092.00	\$1,000,000.00
14	56	\$17,830.00	7.50%	6.21%	\$308,494.00	\$1,000,000.00
15	57	\$17,830.00	7.50%	6.21%	\$351,037.00	\$1,000,000.00
16	58	\$17,830.00	7.50%	6.21%	\$396,885.00	\$1,000,000.00
17	59	\$17,830.00	7.50%	6.21%	\$446,422.00	\$1,000,000.00
18	60	\$17,830.00	7.50%	6.21%	\$499,985.00	\$1,000,000.00
19	61	\$17,830.00	7.50%	6.21%	\$557,926.00	\$1,000,000.00
20	62	\$17,830.00	7.50%	6.21%	\$620,648.00	\$1,000,000.00
21	63	\$17,830.00	7.50%	6.21%	\$688,601.00	\$1,000,000.00
22	64	\$17,830.00	7.50%	6.21%	\$762,299.00	\$1,000,000.00
23	65	\$17,830.00	7.50%	6.21%	\$842,277.00	\$1,010,732.00
24	66	\$17,830.00	7.50%	6.21%	\$929,064.00	\$1,105,586.00
25	67	\$17,830.00	7.50%	6.21%	\$1,022,846.00	\$1,206,959.00
26	68	\$17,830.00	7.50%	6.21%	\$1,124,176.00	\$1,315,286.00
27	69	\$17,830.00	7.50%	6.21%	\$1,233,649.00	\$1,431,032.00
28	70	\$17,830.00	7.50%	6.21%	\$1,342,281.00	\$1,543,623.00
29	71	\$17,830.00	7.50%	6.21%	\$1,440,973.00	\$1,628,299.00
30	72	\$17,830.00	7.50%	6.21%	\$1,547,073.00	\$1,717,251.00
31	73	\$17,830.00	7.50%	6.21%	\$1,661,201.00	\$1,810,709.00

Now, look at the total accumulated cash value at age 73 (at the bottom of column 6) of \$1,661,201.00.

Compare that \$1,661,201.00 with the *Buy Term & Invest The Difference* model's investment account balance of only \$766,948.29 at age 73 (in the 31<sup>st</sup> year).

That's 116.60% more! More than double!

In addition, in that 31<sup>st</sup> year, he would also have a death benefit of \$1,810,709 (at the bottom of column 7), whereas with the *Buy Term & Invest The Difference* model, he would have no death benefit whatsoever because the 30-Year term policy would have expired.

In regards to the cost of insurance in the Indexed Universal Life Insurance policy, the 7.50% rate of return was ONLY applied to the internal rate of return of the cash value in the policy. The actual premium dollars-in versus dollars-out calculation resulted in a 6.21% rate of return.

Keep in mind, there was a cost of insurance in the *Buy Term & Invest The Difference* model as well (\$45,660 over the 30-year term to be exact) which would bring the actual dollars-in versus dollars-out compounded annual growth rate in the *Buy Term & Invest The Difference* model from 2.61% down to 1.82%.

So in summary, here's what the math tells us...

	BUY TERM & INVEST THE DIFFERENCE		INDEXED UNIVERSAL LIFE INSURANCE
AFTER FEES, TAXES & COST OF INSURANCE CAGR:	1.82%	vs.	6.19%
ACCOUNT BALANCE IN YEAR 31:	\$766,948	vs.	\$1,661,201
DEATH BENEFIT IN YEAR 31:	\$0	vs.	\$1,810,709

As I have continually stated, my own opinions on this subject matter are irrelevant, and so are yours.

The only thing that matters is what the math tells us.



I ran this comparison with the exact same projected 7.50% rate of return in both scenarios, with the exact same death benefit amount in both scenarios.

The IRS and the State of California told me what the income tax bracket would be on this hypothetical client making a household income between \$250,000 - \$400,000. If you want to debate the math with the IRS and the State of California you can, but you'll lose that debate.

The investment fee structure of 2.65% is actually a conservatively low number. Forbes says the national average fee structure for mutual funds is 3.10%. Again, you can't argue with the 2.65% number I used.

The numbers don't lie.

So you see, when it comes to retirement planning options, people's opinions mean absolutely nothing. The ONLY thing that matters is the math.

So do the math, and the math will tell you the truth.

## **Non-Life Insurance Options**

I'm going to discuss some other options in this final chapter, however I will say that the *Indexed Universal Life* policy design is very popular right now with our clients because the power of the 0% protective floor is invaluable, especially in this economic time.

But are there other options besides a life insurance policy that offer the 0% protective floor?

The answer is *yes*.

Another option that incorporates the 0% protective floor is an *Indexed Annuity*.

Annuities have gotten a bad reputation mostly because the wrong annuities have been sold to the wrong clients by advisors that were either ignorant or incompetent.

I've personally seen several annuities that were completely inappropriately sold. So before I begin explaining the *Indexed*

*Annuity* concept, let's start by discussing what an annuity is, and what it should be used for.

Annuities are financial vehicles that are typically designed with the intention of you keeping your money in them for 6, 7 or 10 years. In other words, you're entering a contract with the insurance company, agreeing that the *plan* is to let your money grow for the term of the annuity.

Despite the fact that the plan is to not touch the money for the 6, 7 or 10 years, there are some annuities allow for partial liquidity (and in some cases, full liquidity), so there is some flexibility in the event that you need to access your money.

The advantage of annuities is that there are typically no fees (unlike investment accounts), the gains are tax-deferred, and there are several risk classes you may choose from.

Let's discuss these benefits and how they affect you.

## **No Fees**

Compared to traditional investments, annuities typically do not charge advisor fees (in the case of *Fixed Annuities* and *Indexed Annuities*).

In a *Managed Investment Account*, you'll typically pay an advisor fee somewhere between 1.00% - 1.20% on the assets (money) they manage for you.

In addition, you'll pay a portfolio expense fee of about 1%. You'll also typically pay a third party manager fee of somewhere between 0.30% - 0.40%, plus an additional clearing and custodial fee between 0.10% - 0.20%.

When you add all of these fees up, the national average is 2.65%.

This means that if you invest \$100,000 in a *Managed Investment Account*, right off the bat you're paying \$2,650 in fees, so you don't have your full \$100,000 working for you. You only have \$97,350 working for you because the \$2,650 in fees came right off the top.

Not only do you lose this money right off the top, you're also losing 2.65% of your total account balance every year to the advisor and their constituents in fees alone.

Conversely, with *Fixed Annuities* and *Indexed Annuities*, you typically pay no advisor fees. So if you deposit \$100,000 into an annuity, you have the full \$100,000 working for you right off the bat.

These advisor fees can really eat into your gains, especially on the more conservative, lower-return portion of your portfolio.

For example, consider the bond funds in your portfolio. If you're earning 3.00% on your bonds, and you're paying 2.65% in fees, that means your net return on your bond funds are only 0.35%.

In addition, consider this...

We're in a low interest rate environment right now, among the lowest we've ever had.

When interest rates rise, which they ARE going to do, what do you think happens to bond values? They decrease due to the inverse relationship between bond values and interest rates.

But that's not all. You're also getting hit with taxes.

## **Taxes**

In addition to paying advisor fees, you're also going to pay taxes on your gains. Due to the high turnover rate of investments inside most *Managed Investment Accounts* (as well as most *Mutual Funds*), you're going to pay short-term capital gains tax on your gains, which is a tax rate equivalent to ordinary income tax.

So let's say you're married filing jointly and your annual income is between \$250,000 - \$400,000. You'll pay 33.00% in Federal tax, plus if you live in California like me, you'll pay 9.30% in California State tax, plus 3.80% in Medicare tax (as of 2015), totaling a 46.10% tax rate.

So let's say your overall portfolio is producing gross returns of 13.00%. Right off the bat, you'll pay 2.65% in advisor fees, taking your gross 13% down to 10.35%.

Then after paying 46.10% in taxes, your net gain will be reduced down to a total of 5.58%.

Plus you've incurred all that risk. We'll get to the risk part in a second, but before we get into that, let's take a look at the tax issue.

With annuities, you get to take advantage of the power of tax-deferral. What this means is that unlike traditional investments, you don't pay taxes on the gains every year. The taxes are deferred until you begin liquidating the annuity.

The advantage of this is that the taxes you would have paid on your gains are reinvested back into the annuity, allowing the larger sum of money to compound year after year.

Once you begin liquidating the annuity in the form of income (usually for retirement purposes), you'll pay income taxes on the money withdrawn, however the tax deferral still works to your advantage despite the taxable retirement income because the amount that remains in your account (the money that you're not withdrawing in that given year) continues to compound tax-deferred.

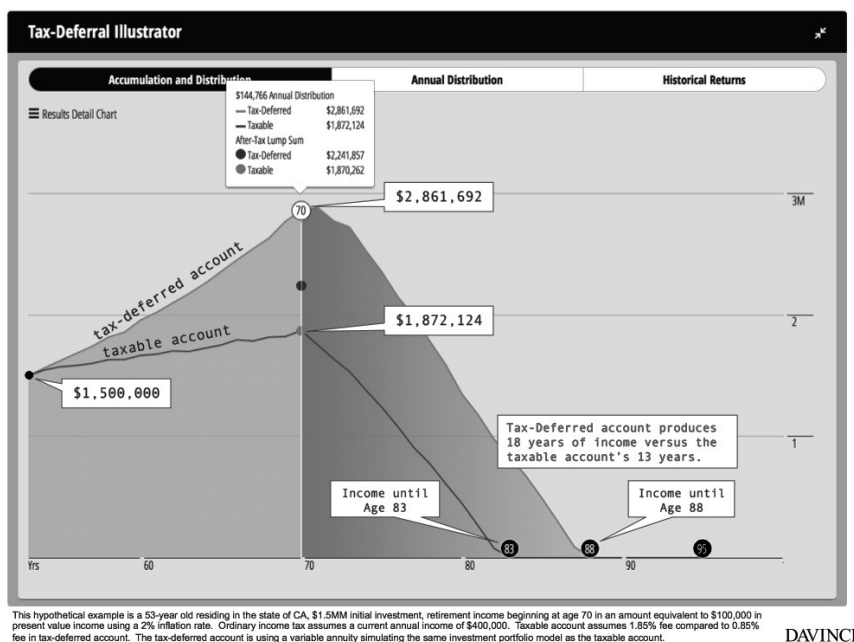
Let's take a look to see how this works.

In the example below, we are looking at a 53-year old that deposits \$1,500,000 into a taxable investment portfolio, compared to the exact same investment portfolio inside a tax-deferred wrapper.

After 17 years the client is 70-years old.

The taxable account has accumulated a \$1,872,124 account balance after these 17 years (age 53 to age 70), whereas the tax-deferred account has accumulated \$2,861,692.

The graph on the next page will illustrate this point.



Starting at age 70, the client will begin taking a *present value* retirement income of \$100,000 (factoring in a 2% rate of inflation). For example, at age 70, the equivalent of \$100,000 in today's money would be \$144,766 in annual income.

At age 75, it would be the equivalent of \$162,277.

And at age 80, it would be the equivalent of \$181,906.

Even though they will pay income taxes on the income coming out of the tax-deferred account (versus no tax paid on the income from the taxable account due to the fact that taxes on the gains have already been paid along the way), the tax-deferred account produces that annual income for 18 years compared to only 13 years from the taxable account.

The reason is two-fold.

One, the tax-deferred account had a larger sum each year, compounding year after year due to not paying taxes on the gains, which got reinvested back into the tax-deferred account. This created a substantially larger accumulated account value at age 70.

And two, as the income was withdrawn from the tax-deferred account, the remaining account value continued to grow tax-deferred each year.

The power of the tax-deferred account is that it produced a retirement income that lasts until age 88, versus the taxable account where the income runs out at age 83, totaling a lost cumulative income of \$1,032,581.

	<b>Taxable Account Annual Income</b>	<b>Tax-Deferred Account Annual Income</b>
Age 83:	\$77,473	\$194,805
Age 84:	\$0	\$199,305
Age 85:	\$0	\$203,909
Age 86:	\$0	\$208,619
Age 87:	\$0	\$213,438
Age 88:	\$0	\$89,978
	<b>Increase In Total Retirement Income:</b>	<b>\$1,032,581</b>

This is merely the power of tax-deferral alone.

Now, let's address the element of *risk*.

Let's say a client cannot qualify for the *Indexed Universal Life* insurance policy due to health reasons, or the client is of an age where it doesn't make mathematical sense to use a life insurance policy as an *accumulation vehicle*.

But let's say they liked the idea of the 0% protective floor. An *Indexed Annuity* could be a great solution that accomplishes a very similar outcome from an accumulation standpoint.

One particular *Indexed Annuity* we like has a 0% floor and a blended 9.91% cap (when combining three different index buckets). In general, *Indexed Annuities* will generate somewhere between a 3.00% - 5.00% return.

Now, you may turn your nose up at those returns, however remember that this product has *zero risk* and *zero fees*, plus it's in a tax-deferred wrapper.

I'm not suggesting you compare this product with the returns you may get in the market, or in an *Indexed Universal Life* insurance policy.

Typically, you'll get better than 3.00% - 5.00% returns in those vehicles.

However, consider the allocation of your portfolio that is sitting in *Bonds* right now.

It is speculated that bonds will only return 2.00% - 3.00% in the next 10 years to come, versus 3.00% - 5.00% in an *Indexed Annuity*.

Again, *Bond* gains are taxed, plus you'll pay advisor fees. But with an *Indexed Annuity*, you'll benefit from tax-deferred gains, plus you won't pay any fees.

Now, am I suggesting that you should dump all your bond funds?

No.

But what I AM suggesting is that you should take into consideration the 0% floor concept, as well as calculate the true net returns after taxes and fees.

I think you'll be quite shocked that what you THOUGHT you were getting is not what you were ACTUALLY getting. Again, when considering annuities, the factors to think about are:

1. Liquidity versus time horizon.
2. Risk tolerance.
3. Tax-deferral.
4. Fees.

You also have *Fixed Annuities* that offer guarantees, which can be a good conservative option.

There are also annuities for clients that don't mind incurring more risk for the potential of earning greater returns.

So when people say they don't like annuities, I find that it's because someone sold them an annuity that wasn't properly designed based on their liquidity needs, their time horizon, or their risk tolerance.

Or perhaps they were looking for higher returns, but forgot about the value of the 0% protective floor. Or, their advisor was a complete moron and didn't explain things to them properly.

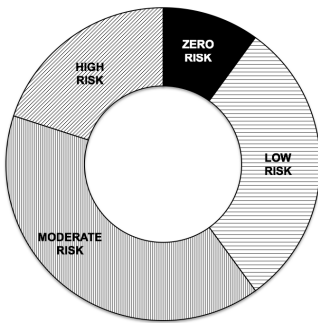
I'd say in most cases, it was the fact that their advisor didn't do an adequate job uncovering what the client's real goals were, didn't recommend the appropriate annuity based on their time horizon and liquidity needs, and didn't communicate clearly what the proper solution was.

The fact of the matter is that if you want to put money away and not touch it for 6-10 years, and if you like the idea of no fees and tax-deferral, it may be wise to diversify your portfolio and have some of it allocated towards the proper mix of annuity options.

Again, you can choose from fixed, indexed and variable options depending on your risk tolerance.

In fact, let's take a look at a hypothetical portfolio and discuss the options in each category of risk.

Conceptually, your overall portfolio should be broken into four different risk categories: *High Risk*, *Moderate Risk*, *Low Risk*, and *No Risk*.



This portfolio design is constructed for a person that has a moderate risk tolerance. As you can see, only 20% of the portfolio is allocated towards *High Risk* vehicles.

In this example, the Risk/Reward ratio is designed to produce moderate overall returns, while taking on a moderate overall amount of risk.

Let's discuss each of these four risk categories.

### 1. The Zero Risk / Zero Return Category:



Typically, the *Zero Risk / Zero Return* category would be held in *Cash*. The reason most people have some of their portfolio in a cash position is for liquidity purposes.

Whether it is used as an emergency fund in case something bad happens financially, or an opportunity arises that requires a cash infusion, having some of your portfolio 100% liquid is typically a prudent thing to do.

In most cases, people keep some money in *Cash* for this purpose.

But let's talk about cash alternatives.

A *Fixed Annuity*, for example, can be an excellent *Cash Alternative*.

For example, one particular 6-year *Fixed Annuity* gives the client a guaranteed 2.00% rate of return if the client holds the annuity until maturity (the full six years).

However, if the client needs to access their money prior to the 6-year maturation, they can walk away with 100% of their principle (the money they originally put into the annuity) without any penalties, fees or taxes due.

So if the client doesn't touch their money for six years, they get a 2.00% guaranteed rate of return, and their gains are tax-deferred.

But if they need to liquidate before the 6-year period is up, they can walk away with 100% of the principle they originally deposited without penalties, fees or taxes due.

So it's liquid (like cash sitting in a checking account), but it gives you a guaranteed 2.00% if you don't touch the money for six years.

This can be a great strategy to fulfill the *Zero-Risk* category of your portfolio because it has all the advantages of *Cash*, with a guaranteed upside of 2.00% if you let the money sit for six years.

Let's compare a hypothetical example.

<u>CASH</u>	<u>FIXED ANNUITY</u>
✓ 100% LIQUID	✓ 100% LIQUID
✓ ZERO RISK	✓ ZERO RISK
✓ 0% RETURNS	✓ 2% RETURNS
	✓ TAX-DEFERRED
	✓ NO FEES

Ironically, I find that most clients were never taught this by their so-called *advisor*.

Why not?

Perhaps it's incompetency.

Maybe it's ignorance.

Or maybe they're being incented to push you into products that pay out higher commissions and accentuate their bonuses.

Regardless of the reasons, you need to be informed of all your options by an unbiased advisor.

Moving on, let's talk about the *Low-Risk/Low-Return* portion of this portfolio.

## **2. The Low-Risk/Low-Return Category:**

*Bonds* are typically used for this category within a client's portfolio.

At the moment in 2015, *Bonds* are producing on average 2.00% - 3.00% returns, and most major financial institutions are projecting that this environment will continue for the next 10-years or so, which I find to be hilarious.

Let me explain why.

If you look at what you get charged in fees, you will quickly start to question your advisor's intentions in regards to the advice they give you.

Remember, as long as they get you to keep your money in the market, they're making their advisor fee (a percentage of all the money you have them managing for you).

No wonder they always tell you to keep your money in the market. When you win, they win. But even when you lose, they still win.

Earlier in this chapter, we discussed the fees a client would typically pay in a *Managed Investment Account*.

Let's recap.

First off, you'll pay an advisor fee somewhere between 1.00% - 1.20% on the assets (money) they manage for you.

Then you'll pay a portfolio expense fee of about 1.00%, plus a third party manager fee of somewhere between 0.30% - 0.40%, plus an additional clearing and custodial fee between 0.10% - 0.20%.

That's a lot of fees.

Add them all up, and the national average in fees paid by the client is 2.65%.

Forbes actually projects that average is even higher at 3.10%. But for the sake of being ultra-conservative, we'll use the lower 2.65% number.

So if you invest \$100,000 in a *Managed Investment Account* with this type of fee structure, you'll only have \$97,350 working for you from day one instead of the full \$100,000.

But that's just the beginning.

If you get a 3.00% return in a given year, but you're paying 2.65% in fees, that means your pre-tax return on that portfolio category is only 0.35%.

3.00%	Gross Return
<u>- 2.65%</u>	Advisor/Institutional Fees
<b>0.35%</b>	<b>Pre-Tax Net Return</b>

But it gets worse.

You've still got to pay taxes on your whopping 0.35% gain. How do you like that?

And all the while, your advisor is still getting paid on the same pay scale, whether you're getting great returns, low returns, or no returns.

No wonder they always tell you to keep your money in the market. From a financial/commission standpoint, they win regardless.

One alternative in this risk category is to use *Indexed Annuities*. The concept is similar to the *Fixed Annuity* concept we just discussed, however *Indexed Annuities* offer a greater upside potential.

*Indexed Annuities* will give you tax-deferral and they also do not charge you fees (similar to a *Fixed Annuity*) so you have your entire capital working for you from day one.

Let's compare the features and expectations of *Bond Funds* versus *Indexed Annuities*.

*Bonds* are *Low Risk*, whereas *Indexed Annuities* have *Zero Risk* (because of the 0% protective floor, similar to the *Indexed Universal Life* insurance policies we've been talking about).

*Bonds* have had average returns of 2.00% - 3.00%, whereas *Indexed Annuities* have had average returns of 3.00% - 5.00%.

In the next chart, these returns are based on a hypothetical example of current industry averages.

Of course, each Bond fund and each Indexed Annuity is going to vary from fund to fund, carrier to carrier, and product to product.

*Bond* gains are fully taxable, whereas *Indexed Annuities* get tax-deferred treatment.

And of course you'll pay advisor fees on *Bonds*, whereas you'll pay zero fees on *Indexed Annuities*.

<u>BONDS</u>	<u>INDEXED ANNUITY</u>
✓ LOW RISK	✓ ZERO RISK
✓ 2%-3% RETURNS	✓ 3%-5% RETURNS
✓ TAXABLE GAINS	✓ TAX-DEFERRED GAINS
✓ ADVISOR FEES	✓ NO FEES
✓ 100% LIQUID	✓ 10% LIQUID PER YEAR

Using *Indexed Annuities* in this capacity can potentially accomplish more favorable net returns than *Bonds*, while incurring substantially less risk (no risk).

Again, has your advisor introduced using *Indexed Annuities* as an alternative to *Bonds* in this particular low interest rate environment?

I'm guessing the answer is *no*.

### **3. The Moderate Risk / Moderate Return Category:**

This category would typically be made of one or more *Managed Accounts* or *Mutual Funds*.

The client would incur *Moderate Risk* in exchange for a potentially *Moderate Return*.

First off, let's revisit the element of taxes on your investment gains.

As I said earlier, in the state of California where I live, if you make between \$250,000 - \$400,000 in income, you'll pay 33.00% in Federal taxes, 9.30% in California State taxes, plus 3.80% in Medicare taxes (as of 2015), totaling 46.10% in taxes.

As a hypothetical example, let's say the *Moderate Risk / Moderate Return* portion of your portfolio is producing gross returns of 13.00%.

Right off the bat, you'll pay 2.65% in advisor fees, taking your gross 13.00% down to 10.35%.

Then after paying 46.10% in taxes, your net gain will be reduced down to a total of 5.58%.

So the 13.00% returns some advisors brag about actually only net out 5.58% for the client. See the math below.

13.00%	Gross Return
<hr/> - 2.65%	Advisor/Institutional Fees
10.35%	Pre-Tax Net Return
<hr/> - 46.10%	Short-Term Capital Gains Tax
<b>5.58%</b>	<b>Actual Net Returns (after fees &amp; taxes)</b>

An alternative option to consider in this *Moderate Risk / Moderate Return* category has historically out-produced this hypothetical 5.58% net rate of return, while again, reducing the risk from *Moderate* to *Zero*.

In addition, it has reduced the tax liability from the hypothetical 46.10% tax rate to *Zero*.

This is the *Indexed Universal Life* insurance policy I've been talking about throughout this book.

If you remember, this product gives you:

1. Tax-Deferred Growth.
2. Tax-Free Retirement Income.
3. 0% Protective Floor.
4. Unlimited Upside, Minus 5%.
5. Liquidity.
6. Flexibility of Premium Payments
7. Death Benefit.

Some of our clients are contributing to this vehicle on an annual basis, however some want to supercharge this strategy and front-load the policy with a large amount up front.

In Chapter 6, I briefly mentioned the *Tax And Miscellaneous Revenue Act of 1988 (TAMRA)* and the *MEC* limits. This is the law that limited how much of the premium dollar can go towards the *cash value* of the life insurance policy.

This law prevents the ability to do a one-time, up-front cash dump into the policy and still get the favorable tax treatment.

Essentially, if a one-time payment was made, the policy would become a *Modified Endowment Contract (MEC)*, losing the favorable tax treatment.

However there is another option that allows a one-time payment without violating the *MEC* limit, while still accomplishing a tax-advantaged outcome.

This is done by using a *Premium Deposit Account (PDA)*.

This is an account held by the insurance company that acts as a holding tank for your annual life insurance premiums.

In order to take advantage of the favorable tax treatment on the cash accumulation within your life insurance policy, you will typically have to fund the policy for a minimum of five years (as opposed to making a large one-time premium payment directly into the life insurance policy in year one).

The way this works is you make a one-time payment into the *PDA*. The *PDA* holds the funds and makes five payments (one payment per year) into the *Indexed Universal Life* insurance policy.

While the funds are sitting inside the *PDA*, you're earning a guaranteed interest rate. One particular *PDA* currently pays a guaranteed 2% rate of return on the account balance.

Essentially, the insurance company calculates the compounded 2% rate of return projected out over five years, minus the annual premium payments coming out each year.

For example, if you made a \$100,000 deposit into the *PDA*, it would pay \$20,800 into the life insurance policy in each of the five years, (versus only \$20,000 due to the 2% interest rate).

The *PDA* can be a great instrument because while the money is waiting to be transferred into the life insurance policy, the 2% rate of return is guaranteed, plus there are no fees on the *PDA* funds.

So if you think about other accounts that earn a rate of return around 2% (like *Bonds*), the *PDA*'s rate of return isn't too shabby.

Again, the key here is that the 2% is *GUARANTEED* (whereas *Bond* returns are not guaranteed and typically incur fees).

Plus, it IS a life insurance policy with a death benefit after all, so ultimately, if you were to die before you were to begin liquidating the cash value of the life insurance policy, your heirs would get the death benefit (usually a multiple of the premiums paid) versus a *Managed Investment Account* (where your heirs would simply get the *Managed Investment Account* balance).

So again, the gains of a *Managed Investment Account* are taxable, versus the gains in an *Indexed Universal Life* policy grow tax-deferred, and liquidated tax-free if done properly.

The *Indexed Universal Life* insurance policy has a 0% protective floor, eliminating downside risk.

The *Managed Investment Account* is vulnerable to down markets, and you could lose both your gains and your principle.

In terms of comparing rates of return, even if the *Indexed Universal Life* insurance policy only produced a hypothetical 7.00% return versus a *Managed Investment Account's* hypothetical 13.00% gross return, after taxes and fees (as discussed earlier) a 13.00% gross return could only net 5.58% versus the *Indexed Universal Life* policy at a net 7.00%.

Now, this is all assuming your *Managed Investment Account* is producing 13.00% gross returns.

What if it only produces 7.00% gross returns?

Let's take a look.

7.00%	Gross Return
<u>- 2.65%</u>	Advisor/Institutional Fees
4.35%	Pre-Tax Net Return
<u>- 46.1%</u>	Short-Term Capital Gains Tax
<b>2.34%</b>	<b>Actual Net Returns (after fees &amp; taxes)</b>

Whoa. Wait a minute.



If you're getting a net 2.34% rate of return, and your paying 2.65% in fees, that means the advisor and the institution they work for is making more than you are.

Let that sink in for a minute.

You're putting up all the money, incurring all the risk, and if you get a 7.00% gross return, you walk away with only 2.34%, but your advisor and his firm walk away with 2.65%.

So if you win, your *financial advisor* wins.

If you lose, your *financial advisor* still wins.

Now, if you really want to compare the true net returns of a *Managed Investment Account* versus an *Indexed Universal* life insurance policy, you'll have to consider:

1. Fees.
2. Taxes.
3. Risk.

And lastly, the *Indexed Universal Life* insurance policy has a death benefit, whereas the *Managed Investment Account* does not.

Obviously, the performance of each example will vary based on market conditions. The 5.58% net return in the *Managed Investment Account* is based on a hypothetical 13.00% gross return, minus 2.65% in fees and 46.10% in short-term capital gains tax.

Compare that to *Pacific Life's IUL* which produced a tax-free cash value internal rate of return of 8.58% for the 10 years between 2006 – 2015, there is no comparison.

<b><u>MANAGED INVESTMENT ACCOUNT</u></b>	<b><u>CASH VALUE OF EQUITY INDEXED UL</u></b>
✓ MODERATE RISK	✓ ZERO RISK
✓ 5.58% NET RETURNS	✓ 8.58% RETURNS <sup>7</sup>
✓ TAXABLE GAINS	✓ TAX-FREE GAINS <sup>7</sup>
✓ NO DEATH BENEFIT	✓ DEATH BENEFIT

When clients see the huge financial advantages of allocating a significant amount of their portfolio towards the

*Indexed UL* – a tax-advantaged asset with a 0% floor – we often times have to remind them that it IS a life insurance policy.

We recommend that our clients have somewhere between 20% - 40% of their overall portfolio in *Indexed Universal Life* insurance cash value.

If your financial advisor hasn't recommended this as an integral part of your portfolio, it begs the question, "Why not?"

I don't mean to keep harping on this issue, throwing other financial advisors under the bus, but from what our clients tell us (and our clients range from working-class Americans all the way up to very high net worth business owners), most of them have never seen portfolios constructed in the way we are discussing in this book.

#### **4. The High Risk / High Return Category:**

Now, in standard portfolios that do not incorporate the strategies we have discussed in this book, the majority of a person's portfolio would be *In The Market*.

Due to the element of risk in the market, that type of portfolio would be constructed in a way to attempt to balance out the risk by diversifying (and in many cases, over-diversifying) their portfolio with a mix of *High-Risk*, *Medium-Risk* and *Low-Risk* options.

The problem with this old-school strategy is that your portfolio is spread so thin that it eliminates any potential homeruns. Too many of your eggs are held in *Low-Risk* baskets.

But if you use the strategy we've been talking about, much of your portfolio is allocated towards *Zero-Risk* vehicles which allows you to *swing for the fences* in the market.

#### **The Proper Portfolio Construction**

The illustration on the next page shows the four risk categories I just finished talking about, along with conventional

options versus the alternative options I've discussed. Remember, this is just ONE hypothetical example of a portfolio.

Obviously your own portfolio would be customized in terms of the ideal allocation into each of the four categories based on your goals, your philosophy and your unique situation.

Let's start by looking at the top right-hand corner of this illustration. This is the 100% liquid, *Zero-Risk* category.

By exchanging the *Cash* for a *Fixed Annuity*, we maintained the 100% liquidity and *Zero-Risk*, however the replacement asset (the *Fixed Annuity*) gets you guaranteed 2% returns that are tax-deferred (instead of 0% with *Cash*), and you incur no fees.

In the low risk category (the bottom right-hand corner), exchanging *Bonds* for an *Indexed Annuity*, we took a *Low-Risk* asset and turned it into a *Zero-Risk* asset, more than doubled the expected net returns (considering the fees incurred on *Bonds* versus no fees in the *Indexed Annuity*), and turned taxable gains into tax-deferred gains.

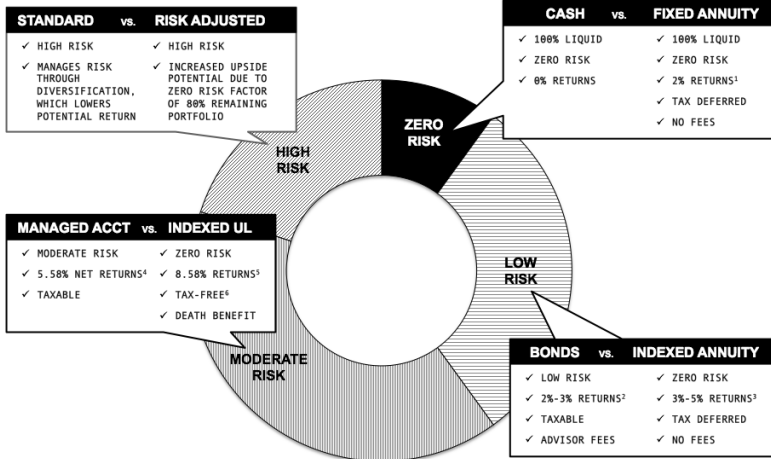
In the *Indexed Annuity*, your money is typically tied up for 7-10 years with 10% liquidity per year along the way, so if you wanted more liquidity, you would logically opt to have a larger amount of your portfolio allocated towards the *Fixed Annuity* and less allocated towards the *Indexed Annuity*.

In the *Moderate Risk* category (bottom left-hand corner of the illustration above), by moving a significant amount of funds from a *Managed Investment Account* to an *Indexed Universal Life* insurance policy, we have exchanged a *Moderate-Risk* asset for a *Zero-Risk* Asset.

Plus, comparing a hypothetical 13.00% gross return in the *Managed Investment Account* (which is only a 5.58% net return after the fees and taxes we discussed on page 113 of this book), one *Indexed UL* we commonly recommend to clients has produced 8.58% returns over the last 10 years<sup>7</sup> (2006-2015), which is pretty darn impressive given that 2008 was included in that 10-year rolling period.

In addition, when done properly, the gains are now tax-deferred and liquidated tax-free from the Indexed UL, versus the gains in the *Managed Investment Account* are taxable.

## MODERATE PORTFOLIO STRATEGY



<sup>1</sup> The guaranteed return on fixed annuities may vary from carrier to carrier, product to product.

<sup>2</sup> The 2%-3% returns on bond funds is a hypothetical example. Actual returns may vary.

<sup>3</sup> The 3-5% return on indexed annuities is a hypothetical example. Actual returns may vary.

<sup>4</sup> The 5.58% net returns on managed accounts is a hypothetical example using a hypothetical 13% gross gain, minus 2.65% in fees and 46.1% Short-Term Capital Gains tax.

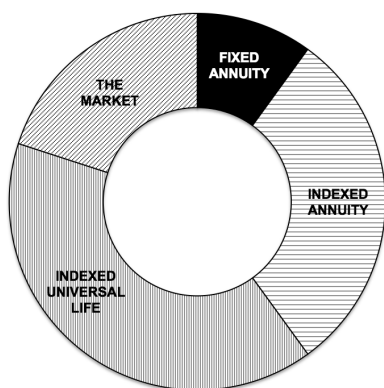
<sup>5, 6, 7</sup> The cash value growth of Pacific Life's Indexed Universal Life Insurance Policies has averaged an 8.84% internal rate of return between 2006-2015. This IRR is not a promise of future performance, rather a historical look over this particular 10-year period. The tax-free gains are technically "tax-deferred" with "tax-free" liquidation based on withdrawals up to basis, then policy loans.

And then, of course, you have the *High-Risk* category in the top left-hand corner. This could be stock picks you have a gut intuition about, a *Managed Investment Account*, or a low cost ETF index account, or whatever you want.

The point is, with the portfolio construction we just talked about, you can afford to take on a lot more risk in this category now.

Here's why.

In the pie chart below, we see a *Moderate-Risk Adjusted Portfolio* with 10% of it's assets in a *Fixed-Annuity* (2% guaranteed return), 30% in an *Indexed-Annuity* (0% Protective Floor), 40% in an *Indexed Universal Life* insurance policy (0% Protective Floor), and 20% *In The Market* (swinging for the fences).



The fact that 80% of the overall portfolio is a mix of vehicles that have either guarantees or 0% Protective Floors allows for higher risk taking in the market because of this risk mitigation. In other words, if you want to really *go for it* in the market, now you can afford to from a risk standpoint.

Again, the example above is JUST a hypothetical example. This model can be adjusted and customized to fit your specific needs.

## The Problem With The Old Model

The problem of investing the OLD conventional way is that much of your faith is put in the hands of so-called *financial advisors* who have huge egos and think they know everything.

They'll brag to you about how they've been *fantasy trading* in a *fictitious account* they brilliantly created, and how their fictitious account is beating the market.

This is just *crystal ball* nonsense.

I've even seen financial advisors construct these customized portfolios that they claim will give you better returns because of *Sortino Ratios* and *Sharpe Ratios* (measurements of standard deviation and volatility within investment funds).

They'll claim that one set of funds is better than another, touting their financial brilliance and knowledge of the market. Every time I question one of these egomaniacs, I always ask them one simple question.

The question I ask them is, "In your financial analysis of these funds, your conclusions and projections about *future* performance are based on *historical* performance, correct?"

“Well yes, that’s all we can base any future projections on,” they’ll always say.

What a joke!

That’s like playing *Monday Morning Quarterback* and saying, “Well, if Tom Brady had run this play instead of that play, the Patriots would have won... and therefore in the future, EVERY quarterback should run this play instead of that play, and they will SURELY win the *Super Bowl*.”

Do you see how absolutely ludicrous that sounds when put in this context?

If history doesn’t repeat itself, then any historical data used to construct an investment portfolio is absolutely worthless.

In my opinion, these kinds of ego-driven financial advisors are completely intoxicated by the exuberance of their own pontification.

In other words, they act like they know it all, when in actuality, they’re gambling with your money. Remember, if you win, they make their commission... but if you lose, they still make their commission. You put up all the money and absorb all the risk, yet they’ll make money off of you regardless.

I remember reading an interview with Warren Buffet and the interviewer asked him what his advice to the general public would be in regards to investing.

His response was interesting.

Buffet said that he tells all of his friends and family to put their money in a low-cost fund that mirrors the S&P 500 and just let it do what it’s going to do.

Puzzled by his statement, the interviewer questioned Buffett by saying, “But that’s not what YOU do.”

Buffett replied, “That’s because THEY’RE not WARREN BUFFET!”

I love this response.

In other words, if you're not *Warren Buffett*, you don't have knowledge, expertise, resources, and the financial means to take risks like he does.

Buffett's stance on this matter was further substantiated in his annual letter to the shareholders of his company *Berkshire Hathaway* in *Fortune Magazine*.

In this 2014 *Fortune.com* article, Buffett says, "I know that I am unable to speculate successfully, and I am skeptical of those who claim sustained success at doing so. Half of all coin-flippers will win their first coin toss; none of those winners has an expectation of profit if he continues to play the game. And the fact that a given asset has appreciated in the recent past is never a reason to buy it."<sup>7</sup>

Buffet's resolve on this issue is so strong that he actually made a public 10-year \$1 million bet against *Protégé Partners*, a New York money manager, that a simple S&P 500 index fund would outperform their fancy-schmancy hedge funds (five undisclosed funds managed by *Protégé*).

The two parties agreed that the winner of the bet would choose which charity will receive the \$1 million proceeds.

As of February 2015, seven years into the bet, Buffett was in the lead.<sup>8</sup>

So as Warren Buffett said, be skeptical of all *so-called Financial Advisors* who claim they can beat the market with their *crystal ball magic*.

Construct a portfolio that incorporates vehicles with 0% protective floors, tax efficiency and liquidity based on your time horizon.

When you have this kind of downside protection based on the strategies discussed in this book (where you are guaranteed to not lose any of your money), you can, at your own discretion, *swing for the fences* in the market.

## Appendix

<sup>1</sup> *IRS Tax Code Section 7702. Source: [www.irs.gov](http://www.irs.gov)*

<sup>2</sup> *Roth IRA Contribution Limits. Source: [www.irs.gov](http://www.irs.gov)*

<sup>3</sup> *Bank of America and Wells Fargo Balance Sheets – Allocations toward Cash Value Life Insurance Assets. Source: [www.fdic.gov](http://www.fdic.gov)*

<sup>4</sup> *S&P/Case-Shiller Home Price Indices. Standard & Poor's and Fiserv. Data through October 2008. Source: [www.standardandpoors.com](http://www.standardandpoors.com)*

<sup>5</sup> *Required Minimum Distributions - 2012 Publication 590 regarding Individual Retirement Arrangements. Source: [www.irs.gov](http://www.irs.gov)*

<sup>6</sup> *IRS Tax Code Section 1035 – Tax Treatment of Cash Value Gains Above Basis. Source: [www.irs.gov](http://www.irs.gov)*

<sup>7</sup> *Pacific Life – The cash value growth of Pacific Life's Indexed Universal Life Insurance Policies has averaged an 8.58% internal rate of return between 2006-2015. This IRR is not a promise of future performance, rather a historical look over this particular 10-year period. The tax-free gains are technically "tax-deferred" with "tax-free" liquidation based on withdrawals up to basis, then policy loans.*

<sup>8</sup> *Fortune Magazine – March 17, 2014 – An Edited excerpt from Warren Buffett's annual letter to Berkshire Hathaway's shareholders. Source: [www.fortune.com](http://www.fortune.com)*

<sup>9</sup> *Fortune.com – February 3, 2015 – Warren Buffet adds to his lead in \$1 million hedge-fund bet. Source: <http://fortune.com/2015/02/03/berkshires-buffett-adds-to-his-lead-in-1-million-bet-with-hedge-fund/>*



*Ouch: How My Financial Advisor Lost Me \$930,000 In Three Years*

## About The Author

Darren Sugiyama is a successful entrepreneur who has built several successful companies in multiple industries.

As a business development consultant, Darren has been sought out by multi-million dollar and billion dollar corporations, seeking his advice on marketing, branding, and leadership strategies.

Today, Darren is a nationally recognized motivational speaker, inspiring entrepreneurs all over the country, and is also an acclaimed author.

His first book, ***How I Built a \$37 Million Insurance Agency In Less Than 7 Years*** has gained national recognition, and is the insurance industry's most cutting edge book, in which Darren shares his secrets on how he built his insurance empire, from nothing.

In his second book, ***Living Outside The Cubicle – The Ultimate Success Guide For The Aspiring Entrepreneur***, Darren reveals his philosophies about living a successful life.

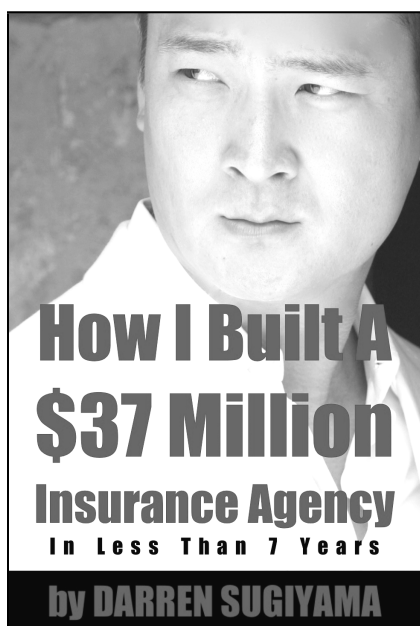
Darren has also authored a novel entitled, ***The Icon Effect – How The Right Mentor Can Change The Course Of Your Life Forever***, an inspirational and aspirational story about a young man who finds a mentor that teaches him how to be successful in life, both professionally and personally. In this novel, art imitates life, as many of the experiences and lessons learned by the protagonist are inspired by Darren's personal journey as an entrepreneur.

Darren also hosts business development and sales coaching *Boot Camp Seminars* where entrepreneurs and sales executives from all over the country fly into Orange County, California and learn from Darren himself.

Among several successful businesses that Darren owns, his wealth management firm, *DaVinci Financial & Insurance Associates* specializes in facilitating the concepts described in this book.

For more information about *DaVinci Financial & Insurance Associates*, visit their website at **[www.DavinciFIA.com](http://www.DavinciFIA.com)**.

For more information about Darren Sugiyama, visit his website at **[www.DarrenSugiyama.com](http://www.DarrenSugiyama.com)**.

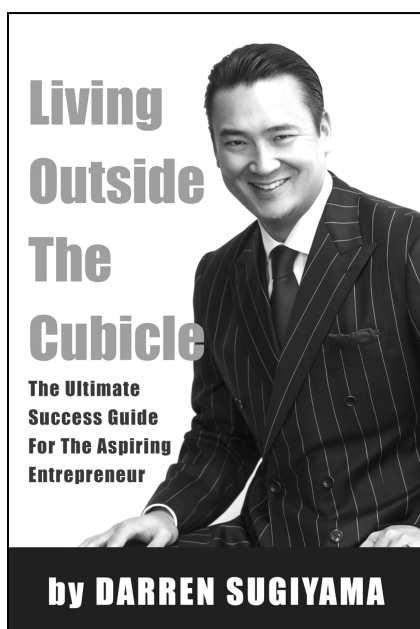


***How I Built A \$37 Million Insurance Agency In Less Than 7 Years*** is Darren Sugiyama's tell-all book about how he started his insurance empire with nothing more than a cell phone, an unorthodox business plan, and a whole lot of ambition.

Darren discusses how to develop a business platform driven by systems (as opposed to being people-driven).

He calls this *The System-Driven Business™*.

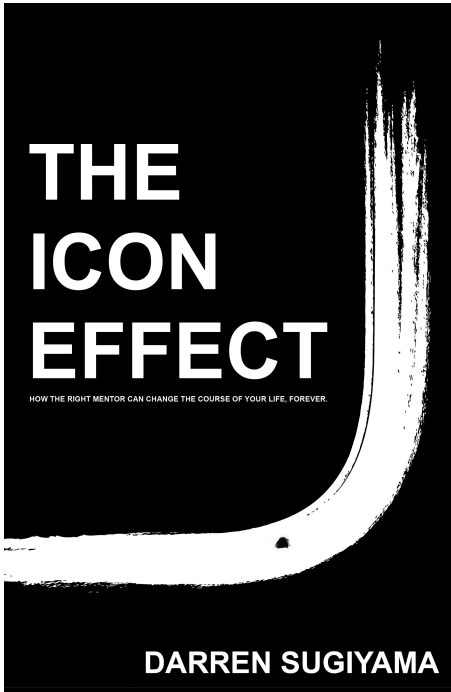
Darren also discusses how to build a strong corporate culture, how to effectively train a sales force, and how to build a company from the ground up.



***Living Outside The Cubicle*** truly is the ultimate success guide for the aspiring entrepreneur.

If you've ever dreamed of accomplishing greatness, or taking your already successful company to the next level, this book lays down the blueprint of how to achieve massive success in both business, as well as in your personal life.

Written by multi-talented entrepreneur, Darren Sugiyama, this book outlines the ultimate goal setting program, describes how to develop your own personal brand, gives you explicit coaching on how to master the art of prospecting and closing, and much more.



*The Icon Effect – How The Right Mentor Can Change The Course Of Your Life, Forever* is Darren Sugiyama's first novel. It is a fictional story about a young aspiring entrepreneur with big dreams. After going through a devastating divorce, Vincent finds himself emotionally drained, lacking confidence and dead broke.

However, a chance encounter with The Icon (a billionaire business mogul) results in a once-in-a-lifetime opportunity to change the course of his life, forever. The Icon becomes his business mentor, his father-figure and his best friend.

The Icon Effect is both an inspirational story and an aspirational story about the power of faith, belief and second chances.

For more information on Darren Sugiyama's books, go to:  
**[www.DarrenSugiyama.com](http://www.DarrenSugiyama.com)**

