FINANCIAL ADVISOR

Cash Value Life Insurance Could Be A Secret Weapon For College Savings

SEPTEMBER 24, 2019 • JERILYN KLEIN BIER

September is Life Insurance Awareness Month and a wealth advisor with a specialty in college planning wants more financial advisors and parents to understand how permanent life insurance policies (including whole life and indexed universal life) can help fund college expenses.

Beth Walker, a wealth advisor with Omaha-headquartered Carson Wealth Management and founder of the Center for College Solutions, a consulting firm in Colorado Springs, isn't suggesting parents abandon 529 college savings plans for permanent life insurance contracts (also referred to as cash value contracts) but thinks the strategy deserves a closer look.

According to Walker, almost every permanent life insurance contract includes loan provisions that enable the policyholder to borrow on the cash value that has accumulated. A parent is typically the owner and the insured on policies used to fund college, she said.

The cash value of permanent life insurance contracts is unlikely to sabotage financial aid awards because it's excluded from the Free Application for Federal Student Aid formula and only a handful of colleges that require the CSS Profile application inquire about the cash value of policies, said Walker.

In addition, policyholders can generally borrow up to 90% of the cash value of their life insurance contracts "with just the stroke of a pen," she said, without having to qualify or have an appraisal. Both of those steps are required when collateralizing a home equity line of credit to pay for college, she added.

"The flexibility of an insurance line of credit is a phenomenal tool during the college years," said Walker.

She also pointed out that the collateral in cash value contracts continues to compound uninterrupted when loans are taken and policyholders are permitted to repay the loans whenever they wish. Some parents wait until they receive a bonus or until their children graduate college, she said, and others may opt not to repay the loan. Outstanding loan balances are deducted from the payout beneficiaries receive following the death of the insured.

That being said, "I would never advocate that you don't pay it back," said Walker, noting there can be surrender charges and parents might need the payout to fund their retirement.

Putting Policies To Work

Walker has used cash value life insurance as a college funding strategy with more than 30 client families. She has also funded a life insurance policy to pay for her son's college education.

Starting to fund a permanent life insurance policy when the kids are in middle school or younger is "a complete no-brainer," she said, "provided the permanent policy is properly designed." At that stage, parents have many years to build cash value before they'll need to borrow the funds to fund college.

Permanent life policies can still be an attractive way to help parents whose kids are in high school manage cash flow challenges, she said, but at that point the policy will likely be earmarked for retirement.

One of her client families bought a house at the height of the real estate market but has no equity in it because property values subsequently crashed, she said. The parents—highly compensated with good jobs and maxed out on their 401(k) contributions—haven't been able to save much for college for their two children who are now in middle school.

According to Walker, the couple is starting to set aside $1,500 a month for college costs through a permanent life insurance policy. The couple will be able to borrow $30,000 a year from the policy and she has factored in a 4% annual inflation increase during the years the clients' children will be in college. "The rest they'll have to get through student loans and merit-based scholarships," she said. The clients plan to repay the loan to their policy by the time they retire.

When Walker comes across clients who inherit money upon the death of their parents, she often encourages them to put the inheritance into a permanent life insurance policy instead of taking a distribution that could disqualify the grandchildren from receiving financial aid.

Cash value life insurance isn't the college funding answer for everyone with cash-flow challenges, said Walker, noting, "A confident practitioner would need to run scenarios."

She cautioned that permanent life insurance is a long-term commitment that shouldn't be taken lightly. "You really have to spend time educating parents," she said. Consumers often don't know enough to ask the right questions, she said, and even people with a license to sell insurance also may not be educated on how it can be used to fund college.

"Because it's a complex tool, with a lot of moving parts, " said Walker, including yearly fees and one-time fees, "you have to really understand what you're doing."
