BARRISTER BULLETIN

Insurance or Investment?

Recently NASCAR driver Kyle Busch and his wife Samantha released a video to Facebook and X explaining how they lost a lot of money implementing what they thought was a safe retirement planning strategy. On the recommendation of a "financial advisor" they purchased an Indexed Universal Life (IUL) life insurance policy because they were told it would provide a tax-free retirement plan, instead they lost more than $8.5 million of the $10.4 million they paid in premiums.

Let's start with how IULs work, they are life insurance products that offer a death benefit, along with a cash value within the policy. The cash value can grow over time based on interest "credited" with the amount of the credit tied to the performance of a chosen index, for example the S&P 500. What makes these policies sound so enticing is that you are told you get to enjoy market upside, up to a certain point, but more important you don't have to deal with volatility and any downturns in the market. So, there is a cap on the upside but loss protection, or a floor, on the downside. If the S&P 500 returns 15% you may only get credited for 8% but if it returns -20% you lose nothing, you just don't receive an interest credit for the year. You also get tax free withdrawals by taking loans from your cash value, avoiding taxes in retirement. Finally, if the cash value grows enough, you eventually don't have to make premium payments anymore. This sounds amazing, almost too good to be true, what could go wrong?!? Well, a lot…

When illustrations are created for policies like these, they rely on several assumptions. Those assumptions, combined with underwriting, ultimately drive the premium cost. In this case, the illustration used an assumed rate of return on the cash value. We don't know the exact rate that was assumed, but we do know that instead of allocating the cash value to an indexed strategy such as the S&P 500, the advisor placed it in a low-interest account earning only 1.5%. The illustration also likely assumed a static rate of return, perhaps around 7% annually. In reality, returns vary year to year, even if these policies protect against losses by crediting a floor of zero. As a result, the projected cash value growth simply did not materialize. Compounding the problem, the cost of insurance was extremely high given Kyle's profession. Between the rising cost of insurance and the low credited interest, any accumulated cash value was quickly depleted. Finally, the financial advisor appears to have structured the policy to maximize his own compensation, reportedly securing a 35% commission. And apparently that wasn't enough,he also recommended an internal life insurance exchange a few years after the initial policy was issued. This exchange provided no economic benefit to the Busch family and instead simply reset the commission payout in the advisor's favor.

So, what can we learn from this? I believe you should invest when investing, and you should purchase insurance when insuring. Using an insurance policy as an investment vehicle works as well as using investments to create death benefits. There is no insurance product that is as efficient for wealth creation as good investments, and investments will not give you the leverage a well-placed insurance product will offer to secure a certain death benefit. There is a reason Warren Buffett owns multiple insurance companies, he likes to receive not pay premiums, and he likes to use those premium payments to invest in quality investments.

Best,

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