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Ohio National Financial Services

Using Cash Value Life Insurance to Establish or Increase a Cash Reserve

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What is cash value life insurance?

Term life insurance does not have cash value but merely provides death benefit protection for a specified term. Other forms of life insurance, such as whole life , variable life , and universal life , include both an insurance and a cash accumulations component. This means that part of each premium payment is invested on the policyholder's behalf and that the proceeds can be used in several ways: to accumulate as cash value, to buy more death benefit protection, or to reduce future premiums. Upon surrendering such a policy, or by taking withdrawals (if permitted) , the policyholder receives whatever cash value is available. The cash value of a life insurance policy may be a source of funds for your cash reserve.

Caution: *The amount of the death benefit will be reduced to the extent there are withdrawals or loans outstanding at the time of death.*

Caution: *Variable life insurance policies are offered by prospectus, which you can obtain from your financial professional or the insurance company. The prospectus contains detailed information about investment objectives, risks, charges, and expenses. You should read the prospectus and consider this information before you purchase a variable life insurance policy.*

Do you have cash value life insurance and, if so, how much?

Most people hold some form of life insurance, whether on themselves, their spouses, or their children. Many of these policies are the cash value type. Often they were purchased several years ago, meaning that they have been accumulating cash value for that period of time. Identify all cash value life policies on you and your dependents. Contact the agent or the policyholder service department of the insurance company to get updated statements on death benefit, cash value, loan value, and surrender value.

Tip: *You will probably need to conduct a comprehensive review of insurance needs and coverage as part of the financial planning process. If so, make any coverage changes part of that process. The discussion here is only about cash value life insurance as a potential source of funds for a cash reserve.*

When is using cash value life insurance a good strategy for building a cash reserve?

When building cash value is not a desirable investing approach

The cash accumulation account of cash value life insurance can be a valuable investment tool. However, you may find that your need for cash value life insurance has changed and building cash value within the policy is not a desirable investment approach. For example, you may have purchased cash value life insurance on the life of your child but now find that you don't need or want to maintain this policy. One option available to you is to surrender the policy and use the cash value to further fund your cash reserve.

Example(s): *Hal and Jane purchased whole life insurance on each other shortly after their marriage 15 years ago. About eight years ago, their insurance representative also sold them whole life policies on their three children. Now, reviewing their insurance needs suggests they surrender their whole life coverage on themselves and their children and apply for term policies. The current combined cash value on these five policies exceeds $5,000, an amount they can apply to their cash reserve.*

Caution: *Surrendering the policy could subject some or all of the cash value to income tax, especially if the policy is classified as a modified endowment contract (MEC). Surrender charges could further reduce the policy's cash value.*

When you need a quick source of cash

You may not want to cash in the policy, but you may need cash quickly from time to time. Life insurance cash values provide availability to cash through policy withdrawals, if permitted, or loans.

Caution: *Withdrawals of cash values are taxable under the "cost-recovery" rule, as long as the policy is not considered a modified endowment contract. That means that they are considered to be nontaxable recovery of cost basis or premiums until your entire* *cost basis has been withdrawn. However, if the withdrawal is within the first 15 years of the policy, there may be situations where withdrawals would be taxable. Check with your insurance company prior to requesting a withdrawal.*

Heed these special considerations

Life insurance is a critical part of your financial plan, especially when you have dependents. Going without such coverage, even temporarily, can result in financial disaster for your survivors. Be sure to carefully plan all changes in insurance coverage and know their implications before making changes.

Caution: *If you plan to convert an existing cash value life insurance policy, do not cancel or surrender the policy until you receive written confirmation from an insurer that the replacement policy is in effect. Otherwise, you could encounter a period, however brief, where you are without any coverage.*

Know the tax implications of any change before you act

The cash value of a life insurance policy represents two categories of money. The first is the sum that was contributed as your premium payments, known as your basis. This is money on which income tax has already been paid. Any money you receive that is greater than your basis in the policy is taxable income. Because income tax may have to be paid on this income, the amount left over for building a cash reserve will be less than the full cash value amount.

Determine how long it will take to receive the money

Insurance companies may not move as quickly as you would like when it comes to cashing in your policy. It can take up to several months to complete the process. Make sure you get an estimate of how long you might have to wait, and factor this timing into your cash reserve plan.

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