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No-load insurance contracts as a savings alternative

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With inflation soaring at more than a 6% clip and interest rates at historic lows, certain no-load insurance contracts have emerged as attractive cash alternatives.

Some highly rated insurance companies offer no-load versions of these contracts as well as a minimum 2.5% annual interest rate. Because these contracts have no up-front load and no back-end surrender charges, they are fully liquid. Additionally, there is no investment risk or interest-rate risk, yet these insurance contracts have earning potential that is much higher than at a bank.

I doubt that the insurance companies intended these contracts to be used as an alternative to savings accounts but given the current low interest rates, the full liquidity, and the earning potential of these contracts, they have become just that.

Over the last seven years, we have seen these contracts earn around 5% to 6% per year after all insurance costs are deducted.

Aside from higher earning potential, these contracts also offer a sizable tax-free life insurance benefit and a valuable long-term care benefit. While your money is making more interest than it would in a bank, the contract owner also receives a sizable pool of additional funds that are available to the contract owner if the insured is unable to perform two or more of the activities of daily living.

This strategy is a very efficient way to plan for potential future long-term care needs. A 1988 tax law called TAMRA codified the tax treatment of overfunded life insurance contracts. These overfunded life insurance contracts (also known as modified endowment contracts) grow tax-deferred and are tax-free at death, but all gains withdrawn during the insured's lifetime will be taxed as ordinary income, just like interest earned in a bank. Additionally, if the insured is younger than 59.5 at the time of the withdrawal there is an additional 10% tax due on the gains. For a free report, text the word NOLOAD to 474747.