Episode 191: From Cash to HELOCs What's in Your Buffer Toolbox

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Retirement income, buffer assets, sequence risk, cash, HELOC, reverse mortgage, whole life insurance, financial personality, portfolio protection, long-term care, Medicaid, surrender charges, interest rates, annuities, principal protection.

SPEAKERS
Wade Pfau, Alex Murguia, Briana Corbin

Briana Corbin 00:00
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Briana Corbin 00:39
Assets say they're here to help in a crisis, but can they really take the heat? Wade and Alex put buffer assets to the test this week, and yes, gold fails the vibe check.

Alex Murguia 00:52
Hey everyone, welcome to retire with style. I'm Alex, and I'm here with my trusted companion, Wade, and today we're gonna continue our Q and A from Wade's webinar on managing sequence risk. And today's focus will be on buffer assets. Buffer assets. But before we get into that, let's buffer this episode with folks who haven't been hearing from you. You know, the last the you know, in the summer, at the start of the summer, what happened? Why was this? Why was there a Wade pause? Well,

Wade Pfau 01:26
we're in the throes of summer, but, uh, you're revealing. We must have pre recorded some of those episodes, because I really wasn't a pause in that regard. No,

Alex Murguia 01:33
I know. I know. I always working, hardest working man in the retirement right here. But

Wade Pfau 01:38
yeah, I didn't have a trip to Japan. Good time, but the exchange rate's still quite good, so you can enjoy nice restaurant meals for half the cost within the US, it's great time to be in Japan.

Alex Murguia 01:52

And why Japan? Wait, this is like the third, fourth year you've gone in a row. Yeah.

Wade Pfau 01:57
Now I'm trying to study Japanese as well, and I'm taking, there's a series of five Japanese language exams taking with my kids. My my oldest was at the highest. Well, they're in reverse numbers, so n1 which is the top one, my daughter and I are at the second level, which is the n4 we both took that test in Japan, and then my youngest was taking the n5 test. There you go. We were there to study Japanese and get ready for tests also.

Alex Murguia 02:22
And many people won't know that you're married to a Japanese lady, and that's that's where the trips come

Wade Pfau 02:29
from. Yeah, and I lived in Japan for 10 years, that's

Alex Murguia 02:32
right, and you didn't even bother with them. All of a sudden you have this newfound love for the Japanese language. Yes,

Wade Pfau 02:41
we've got a little more time now than I did when I always should have been studying more, but trying to learn all those characters and everything.

Alex Murguia 02:49
Yes, yes, that's you wade, lifelong learner, lifelong learner. All right, all right. Let's get to these questions then here, before we begin, though, in the similar way that you did in the last episode, you gave everyone a quick rundown on ways to mitigate sequence of returns risk. Do you want to talk about the types of buffer assets? Sorry, the types of buffer assets that you usually refer to? Yeah.

Wade Pfau 03:15
So Buffer assets was the fourth way to manage sequence risk. It's the idea you have something outside your portfolio that's not correlated with the portfolio. So it which means just if markets are down, your buffer assets not losing value, and then you can temporarily tap into that to meet expenses, giving your portfolio an opportunity to recover before you then resume spending from the portfolio. And I talk about three buffer assets, cash, cash on the sidelines, which, in theory, I don't know, to be a buffer asset. You're kind of carving it out of your portfolio, but if you just considered it as part of your portfolio, it means you could have used a lower withdrawal rate from your portfolio. Cash is a bit of an odd duck, but cash the growing line of credit on a variable rate Home Equity Conversion Mortgage or reverse mortgage, and then borrowing from the cash value of permanent life insurance, in particular, whole life insurance, cash value life insurance, whole life insurance isn't exposed to losses as well. And so those are the three potential resources to use as buffer assets. Now, all three of them can be expensive to use your your borrowing and well, especially with a reverse mortgage as well, you have to set it up with life insurance. Usually you don't see the charges, but there's going to be a big commission baked into the pricing and everything else. But in the simulations and testing I've done showing how, even after considering those expenses, the synergies created by how this helps protect your

portfolio, by not having to sell from it temporarily, can get you into a better position so that you can pay for those expenses, including the interest on the loan, growth and so forth, and still have more. Are left at the end. And so buffer assets can be a really effective way to help manage that sequence of returns risk as well. And it can be a way to just allow you to use the higher initial distribution rate from the investments at the same time, because, you know, you have this backstop to provide that temporary spending resource as well.

Alex Murguia 05:18
So effectively, it's, it's effect, it's, it's just an earmarked piece chunk of money that you have, that you can go to in case of in case of fire, you know this, that's where you break the glass. You know, it's not, it's not commingled or anything like that. When I hear you talk about it, it's that kind of vibe that really, yeah, settles it for me.

Wade Pfau 05:41
Yeah, and that makes complete sense, I think, with the the reverse mortgage and the life insurance, it's just with the cash pile, it's, why are you treating that as being separated from your portfolio? Sure you could. It's more than it's more like a

Alex Murguia 05:54
that's more it helps you, you know, the cookie jar disciplines, kind of thing. But all right, and so then we got a lot of questions with that says, you know, Wade laid the ground for like, these are the four that we feel are buffer assets. But there's always folks of, what about what about this, what about that? And so I think it was helpful if folks can, like, you know, parcel out the commonalities of what, what those buffer assets have, you know, when, especially when we start throwing these out. All right? And so here we go. This is from irshot. Wouldn't a HELOC also be a suitable buffer asset you couldn't repay it when your portfolio recovers from a drawdown?

Wade Pfau 06:39
Yeah, this question when I talk about reverse mortgages, this is probably one of the most common questions, why not just use a HELOC, which is the home equity line of credit. Usually it's cheaper to set up a HELOC, and so I think that's the motivation for the question, but that's really where its advantages end. So HELOCs can be frozen or canceled. And if you're using a buffer asset, the idea is you want to spend from it when the markets are not doing well, because that's the whole idea. You want to protect your portfolio when it's not in good shape. And HELOCs can be frozen and canceled. And that's we saw this during the pandemic. We we really saw this back like with the financial crisis in 2008 one of the early groups of researchers that promoted the idea of using the reverse mortgage, it was Harold evensky and John Salter, and they they run a financial planning firm where they had HELOCs for their clients to use, really, as buffer assets. And then the financial crisis of 2008 happened, and that's exactly when they want to tap into those buffer assets. And they were frozen, they couldn't tap into them. So that led them down the path of looking for the alternative. And so Home Equity Conversion Mortgage, the hecum, the reverse mortgage, it can't be frozen or canceled. That's the number one major advantage over HELOC, other advantages of the hecum, it has a growing line of credit, so you initiate it, and then that line of credit grows over time. Whereas a hecum would be fixed, I'm sorry, with a HELOC would be fixed, and then also with a HELOC, you can have a more more of a fixed repayment schedule, so that you have less flexibility. Whereas with the hecum, you can delay any repayments until you move out of the home, and so you've got more

flexibility there. And then also when you're retired, it may, in some cases, be harder to qualify for a HELOC if you don't have income and so forth. So that's the main difference, is if, and that's why I really think you can't consider a home equity line of credit or HELOC to be a buffer asset. It's just you need that to be there when the markets are down, and it probably won't be there when the markets are down. It's there for the good times, but it's not going to be there for the bad times. The reason to have a buffer asset is have it there for the bad times.

Alex Murguia 08:59
And I concur, we, we went through the same issues with with a lot of our clients during those two eras where, yeah, clients, clients who are dependent on HELOCs, just for their just normal activities, normal, quote, unquote emergencies that they could tap into, they weren't able to, and they were called and so that that did to Wade's point, they're there for the good times, but they're not there necessarily for the bad times, because the banks during the bad times don't want to, don't want anything to do with it, unfortunately. But you saw next question, what about my goes as a buffer asset in parens, the liquidity

Wade Pfau 09:43
now, so the HELOC, I would say no wave on the buffer asset for the myga, under limited conditions, I could accept it as being a kind of three and a half buffer assets. So well, mangas, they're the multi year guaranteed annuities. They're they're much like CDs. And they pay a fixed rate for for a given period of time, and then you can renew them. They work a lot like CDs, but they're in the annuity world. Now, most any sort of deferred annuity, like a myga, does allow free with free surrenders or free withdrawals from the account, and if you go up to that limit, you don't have to worry about paying any sort of surrender charges as soon as you get into the surrender charge. Discussion like, if I had a mica, and I want to draw from it to meet expenses, I want to use it as a buffer asset. Well, if I have to pay surrender charges on those distributions, that's a loss. I may have a 10% surrender charge. So that's that's definitely falling outside the bounds of being a buffer asset, but if it has fairly liberal abilities to draw from it without surrender charges, you could potentially consider it a buffer asset. I think the only other potential downside as well is interest payments. And this may be less of an issue with a myga, but say you had a six year deferred fixed annuity that doesn't pay any interest until the end of the six years. Five and a half years into that period, you want to draw from it to use it as a buffer asset you may get sacrifice getting interest for the past five and a half years. So that's another thing to be careful about. But if you're avoiding these kinds of problems I'm mentioning, I'd be okay considering a multi year guaranteed free withdrawals from it as a buffer asset.

Alex Murguia 11:35
Okay, what about I'll ask one. What about CD, LIDAR? Same, same logic,

Wade Pfau 11:42
Yeah, same sort of logic, same sort of potential. Well, there's, well, same sort of potential caveats. Just what are you having to give up if you draw from it before the maturity date, if it's minimal, or if it's just like say, you might have to give up three months of interest or something that might be acceptable, and you might be able to consider and it does allow you to draw from it. If it's completely locked up, then it can't be a buffer asset, but if you can draw from it with minimal cost, you could potentially consider it as a buffer asset.

Alex Murguia 12:12

I'm going to throw a question here. I know we have some already, but this is a quick one, and I say it because I woke up early this weekend and I was channel surfing and CNBC was on, and in the mornings they do, like gold, like buying the actual coins and stuff like that. And and they were pitching, and I knew this was coming up, and they were the commercial or the infomercial. They were pitching in terms of, I can hold it, I feel good it, it protects. They were almost saying, like, a buffer to the buffer, like a buffer to the buffer asset. And so I was almost curious, what are your thoughts on? I mean, I know the answer, but I'd rather have everyone hear you sit. What are your thoughts in terms of gold serving as a buffer asset, because it provides the ultimate protection

Wade Pfau 12:55
so the buffer to the buffer? No, the whole point of the buffer asset is it can't be correlated with the portfolio. But again, that's just a fancy way of saying, if your portfolio's down, you don't have to worry about your buffer asset also being down, and gold prices are volatile, so you don't have that worry free aspect of I know gold's not going to decline in value when I need to use it to cover my expenses. You may have to sell at a loss with gold, it's volatile, just like the portfolio, anything that's volatile in the downward direction exposed to losses is not a buffer asset.

Alex Murguia 13:34
So who watches the watchman,

Wade Pfau 13:36
yeah, and that's the why the mica, it any deferred fixed annuity has principal protection, so you're not exposed to a loss. In that regard, your principal is protected. That's where, if you can draw from it without cost, you could potentially treat it as a buffer asset. But no gold does not have principal protection.

Alex Murguia 13:58
Again, just they were, they were sort of pitching it as like, this is what you need when times are tough, kind of, all right, so let's move on here. What about a growth oriented, fixed, indexed annuity parens without guaranteed living withdrawal benefits writer as a buffer asset?

Wade Pfau 14:18
Yeah. And so both of the mica and then this question. We're both from Fred, and the answer is pretty much the same, with the same caveats, as with a myga, an FIA instead of paying well, you could choose an FIA that pays a fixed rate, or you could choose the FIA that is going to provide principal protection, but then it's linked to a market index, and based on the performance of that market index, you could receive a positive return. So your if that index was down, your principal is protected. If that index is up, you'll share in some percentage of the index growth, and so you get a variable positive return instead of a fixed positive return. Yeah. So in that regard, no difference. You could treat that as a buffer asset in the same manner as a mica, and it's really just the same. Caveats. Are there surrender charges? They're maybe having to wait till the end of the term before you get paid any interest, so that you potentially lose a lot of interest if you draw from it.

Alex Murguia 15:18
Yeah. There may be some folks that you mind giving quickly the an FIA and what the the benefits do to the writers?

Wade Pfau 15:26
Well, this is without writers. Yeah, you can, sorry, sorry, I read it with sorry. If you had a guaranteed lifetime withdrawal benefit, then you can use it for lifetime income, and it behaves more like an income annuity if you're not adding a guaranteed lifetime withdrawal benefit, it's really the case where you're using it more for accumulation, and then you might when you're thinking about your fixed income bonds and so forth. Are there potentially annuities, and they also provide tax deferrals, so considering that as well, but potentially annuities that might offer competitive yields with respect to other bond options you have available. And of course, bonds don't have principal protection. If interest rates go up, you sell at a loss. And we saw that clearly in 2022 and a lot of bond funds had double digit losses. That's where a deferred fixed annuity, and so an FIA and a myga are both examples of that. They're not exposed to that interest rate risk in terms of their principles protected. You don't have to worry about selling at a loss, other than all these caveats about, well, if there are surrender charges and things, then you would have to sell it a loss, and then it's not a buffer asset,

Alex Murguia 16:43
all right, so it's really the the infrastructure wrapper is what dictates, you know, if it's a true buffer asset or not the, you know, the vehicle itself, but the actual investment or the way it's structured, it is. But, you know, depending on which one you bought, how you bought it, that's what could

Wade Pfau 17:02
Yeah, shorter terms. But again, let me emphasize that point. Like, if I bought a six year fixed index annuity, and it's not gonna pay me any interest until the end of the six years. And five and a half years into that, and say, the market's been up 100% whatever index is attached to, well, then you probably don't need the buffer asset. But the point is, if I don't hold it till the end of the term, I may not get any interest, and that could be a very costly way to structure a buffer asset as well.

Alex Murguia 17:30
There you go. All right. So next question, reverse mortgage. Oh, no, sorry. Would love to see your analysis if it included all the costs associated with a heckum. Heckum strategies do not come from the free store. What does come from the free store? Wade So I can start shopping there. By the way, there

Wade Pfau 17:51
is no such thing as a free lunch. And that's from Kenneth. Yeah, that's Ken So great question. And let me refer you to my book, reverse mortgages,

Alex Murguia 18:03
we just like shifted the camera angle of his

Wade Pfau 18:08
no in my reverse mortgages book, I do a number of case studies where I show a number of different strategies that use hecms, but I include all the costs, even I include retail costs you might be able to negotiate on some of this, I include the full retail costs of setting up the reverse mortgage and then also a healthy margin rate as part of the loan. So any benefits that I show are net of costs, and I don't skimp on the cost, because the potential benefits are so strong,

again, you can cover those costs and still have net positive outcomes. So I don't skimp on the costs when I'm simulating different strategies with the HECM. So the analysis includes all closing costs. I think, in the case study in the book, it's just setting up the reverse mortgage was running you close to $20,000 and the main closing cost is the 2% mortgage insurance premium on the home value, but, yeah, I definitely don't skimp on the costs when I'm testing those types of strategies.

Alex Murguia 19:09
Here's a here's another question. It goes back to this, and I'm going to ask it, but I'd like to get your take on something beforehand. It's reverse mortgage is a risky option because most banks stop doing them after the GFC, right? My, my question has to do with, you know, in line with questions like this, is, have you seen the tide shifting in terms of how people view reverse mortgages, let's say over the last five years? You know, roughly when you first published your book, just simply because, yeah, what? Yeah, when you first started talking about this, this stuff was, like, kryptonite, Oh, you don't do this. This is, like, late night infomercial, you know, gotcha kind of strategies. Don't do that. I you know, you're one of the first to kind of be like, well, let's do the math behind this, right? And so I'm just curious if you've. Guide. And you know, if you've seen, I wouldn't say groundswell, but have you seen a greater acceptance over the last few years as this as a viable strategy?

Briana Corbin 20:10
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Wade Pfau 20:35
This is a tough one, because I saw a lot of acceptance. Like, if we talk about, like, what tracking acceptance over time? 2016 was a golden era. That's the year my the first edition of my book came out. Not that there's any connection, but there were news stories all over the place, even, like print editions of Time Magazine talking about the value of reverse mortgages. So I thought they were gaining a lot of momentum then. Then there was a real change in 2017 and usually there's real changes every four or five years, but we're kind of way overdue now. 2017 was the last major rule change, and that took away a lot of momentum about the line of credit growth. Like I hadn't done simulations, in 2016 after about 20 years with a reverse mortgage, you got a 5050, chance that the line of credit's worth more than the home, and then, because it's a non recourse loan, that would create windfall opportunities. There was a professor at MIT that called it the roofless option. You just open up a line of credit, leave it alone, wait till it's worth more than your home, and then take it all out, and then you only, only 95% of the appraised value of the home is what you have to pay back. That's a lot harder to happen. It's not impossible, but it's a lot harder to happen today because of the real changes made in 2017 and part of those rule changes were there's now that 2% mortgage insurance premium prior to that rule change, you the closing costs could all be credited, and you could get down to there. Talked about the $125 reverse mortgage you had to pay for the counseling session, but the lender would credit everything else that they couldn't credit the counseling session. By law, that 20 $125 reverse mortgage quickly went up to the 15 or $20,000 reverse mortgage, and it's just been hard to get momentum after that, because even though the benefits can exceed the costs that upfront, sticker shock, I think can be a big hurdle for people. And so I think advisors have become more

open and can can see their value, but in terms of trends, we're not seeing more reverse mortgages today than we did five or 10 years ago. And if anything, it's kind of reversed because of these higher initiation costs.

Alex Murguia 22:53
I see what you did there,

Wade Pfau 22:56
but that's a question you asked. So back to Steven's question, is the reverse mortgage a risky option because most banks stop doing them right after the I guess the GFC means global financial crisis,

Alex Murguia 23:10
financial crisis,

Wade Pfau 23:12
or the grand financial crisis.

Alex Murguia 23:16
I guess would be global,

Wade Pfau 23:18
global Oh, global financial crisis. That's better doesn't make it sound positive, at least like finance grand financial crisis. Well, the second part of the sentence is true. The large banks all dropped out after the grand, great global financial crisis. That doesn't necessarily make them riskier, though there's still a number of lenders, and we're talking about the 90% of reverse mortgages in the US are the heck program administered through the federal government, the Home Equity Conversion mortgages. And so there's all kinds of protections in place. In fact, the reason the insurance costs are so high are because of these protections. They can't be frozen or canceled the you if the lender goes out of business that you still will have access to to it, because it will go into the general government Mortgage Insurance Fund. So that didn't make them a riskier option. That's really that's all there is to say, yes, the big banks dropped out. No, that doesn't make them riskier. And over the years, now, Mutual of Omaha is a big company that's now back in the reverse mortgage game. But indeed, all the wells, Fargo's and banks of America and those types of institutions, I think they just saw there's too much reputational risk.

Alex Murguia 24:37
Well, there's also this Wade, and I was speaking to a banker, and you mentioned this as well, like even regional banks and small banks, think about the business of a bank. The bank is to lend you money so you purchase capital, right? And you know, you always a reverse mortgage is the opposite for the bank in which they're like. Like, you know, they're slowly accumulating a property, you know, in some way. And that's not what they're in the business for, if you will. You follow what I'm getting at. Like, they they want to lend you money, so you buy a house, not necessarily, you know, kick money out, and then they're slowly accumulating the equity of the house.

Wade Pfau 25:19

Yeah, that makes sense, and the reputational risk, and I think there was a big factor too. It's so when you have a reverse mortgage, you have to maintain basic homeowner obligations, basic upkeep, pay your property taxes, keep homeowners insurance, and if you don't, you could potentially be foreclosed upon. And so they the story about the widow whose home was foreclosed because they had a reverse mortgage, even though, at the end, if you really analyze a situation, that reverse mortgage might have given them a much more comfortable life for an extra few years before the inevitable happened, that they eventually just ran out of the ability to meet expenses. But nonetheless, the story in the newspaper is big bank foreclosed upon widow, and I think that reputational risk was a big driver of why they just your point too. It's just maybe more trouble than it's worth for them. I don't think

Alex Murguia 26:11
the banks are in the business to, over time, buy houses. They want to get that stuff off their balance sheet. They want to act like a mortgage, not the other way around. Uniting is like reverse life insurance. Well, you know, they don't want to reverse mortgage. They want a mortgage, right? That's what they're in the business for, and that's why they're more specialty financial institutions that do the reverse mortgages. If you borrow from the whole life, if you borrow from the whole life insurance, your sleep and run more reversible. Okay, my bad, my bad. Let's go back again. Hi guys. Long time listener. Love your show. Did you write this way?

Wade Pfau 26:54
Thank you. Is

Alex Murguia 26:56
your mom writing in again? This

Wade Pfau 26:57
one's from Avid boater in the YouTube comments. The discussion,

Alex Murguia 27:02
is there any research that explores the feasibility of using a reverse mortgage as a substitute for long term care insurance? In particular, does it make sense to set up a HECM with the intent that it will only be used for long term care and only if no other funding sources are available? I've read Wade's book on reverse mortgages, and I plan to go through it again, but what are the implications of ongoing expenses of a HECM versus ongoing expenses of long term care insurance?

Wade Pfau 27:30
Yeah, it's a good question, and we got to put two big potential caveats on trying to use the reverse mortgage as a alternative to having long term care insurance. The first caveat is to keep the reverse mortgage going, you have to live in the home so it it could be a great way to pay for in home care. Most people may prefer having in home care, like a someone coming to the house on a daily basis to provide that care. But if you need to move into an institution, and if I don't know, we're talking about a single person, or, like, if it's a couple, as long as one person still living in the home. But the idea is if, if the last person had to move out to go to a nursing home or assisted living facility that closes the reverse mortgage, you can't borrow from it anymore. And in fact, that is creating a situation where you have a year to pay back the loan balance, so you can't treat it as a way to pay for institutional care. It'd only work as a way to pay

for in home care. The other caveat is, if we're getting in a scenario where all you have left is the home you really have to look at state laws about Medicaid. Also in some states, you may not the home may be protected so that you could qualify for Medicaid and not have to spend down the value of your home. You really it's, it's a state by state basis, but just you'd want to be thinking about, how do the medic because Medicaid can also pay for long term care if you run out of resources. So you want to understand how the home is treated as part of those Medicaid calculations in your state. And again, you want to be clear about this caveat. You can't use a reverse mortgage to pay to live in a assisted living facility or any you can't move out of the house and use the reverse mortgage to pay for that. That's all I have to say about this.

Alex Murguia 29:28
I would also think, and this is just a general break even thing, you have to assume also, that the care that you're going to need is going to be less than the amount that you could take from the equity line.

Wade Pfau 29:43
That's not right. Eventually you may qualify for Medicaid. It's just a matter of, did you have to spend on the value of the home before you qualified for Medicaid? All right.

Alex Murguia 29:52
All right. So next question, if you borrow from whole life insurance, do you pay that loan back later? I.

Wade Pfau 30:00
Yeah, yes, and actually, there's the next question. I'll just say yes for now, because the next question actually presents, we can have more discussion about that.

Alex Murguia 30:09
Why didn't you? Why didn't you tell me to answer this question? I could have just said yes. I get my question in

Wade Pfau 30:17
whole life. You have to pay the loan back later. It's not a

Alex Murguia 30:21
free money. Let me answer this Yes. If you are from home life, you're gonna have to pay the loan back later.

Wade Pfau 30:26
Yeah, it doesn't come from the free store. To quote earlier question,

Alex Murguia 30:31
the free store is closed. They're selling trees. They started a nursery.

Wade Pfau 30:38
You can explain more after the next question. All right,

Alex Murguia 30:43

the hygiene is over. Let's get to the question here, if you borrow from a whole life policy, it is an interest bearing loan, and loans have to be repaid. Question is, does it get repaid when you die and you have a lower death benefit, or do you have to pay it back while you are still alive or risk the policy imploding, leaving you with a tax bill. I guess it all depends on when you take the loan and for how much,

Wade Pfau 31:13
right? So let's put a caveat on the answer that make sure you understand the specific terms of your policy, but in the general sense, it could be paid back from the death benefit. It's what has to be carefully managed. Is the cash the loan balance cannot exceed the value of the cat, the cash value while you're alive, or the death benefit if you're dead, or maybe the let me say the loan balance cannot exceed the cash value in the policy. That's what blows up the policy and could make it taxable. So you want to be very careful. And if the loan balance is getting too big while you're alive, you may have to pay off some of that loan balance to make sure it's not bigger than your cash value. But that aside, generally speaking, if you pass away with a loan balance, it's just going to be paid from the death benefit, and then any remaining death benefit would go to your beneficiaries. And that doesn't create a taxable

Alex Murguia 32:16
event. Just because of some listeners, you know some this because some like, that's probably good cash value. What does that mean relative to whole life policy?

Wade Pfau 32:27
So permanent life insurance, like whole life term policies, are the most simple. They just have a death benefit, and if you surrender it at any point, you don't get anything. It's you just you have that death benefit. Permanent life insurance usually has some sort of cash value because it kind of merges elements of investing with life insurance. And so the cash value is another in addition surrender charge. But once you pay any surrender charges, if I decide to just close the policy and stop paying the premiums, I'd get any cash value in the policy back after any surrender charges if I tried to do this too soon in the process. But

Alex Murguia 33:07
a cash value is an amount that accumulates during the life of a policy. So in addition to the death benefit, you have a site account that's been grown, and you could potentially tap into it via a loan.

Wade Pfau 33:18
And most policies are calibrated so that the cash value gets up to where the death benefit is by either age 100 or 120 otherwise, the cash value is less than the death benefit, and you can borrow from the cash borrow against the cash value, and that's what the reverse mortgages and whole life insurance. It's a very similar conversation with a reverse mortgage. It allows you to borrow against the home with whole life insurance. The idea of the buffer asset is you'll borrow against the cash value.

Alex Murguia 33:54
Yeah, and it's meant, and theoretically, you can see why it's meant to be able to become more or less on par with the death benefit, because that meant the insurance company was properly adjusting the rates to get to that right level.

Wade Pfau 34:09
And then the concern in that question, if the loan balance grows to be more than the cash value, that can trigger a taxable event that you would really want to avoid. So you do have to monitor that, but just dying with a loan balance in place does not trigger a taxable event. It would just be paid back and just again. Generally speaking, there may be some exception out there. Generally speaking, if someone dies with a loan balance because they were using it as a buffer asset. Say the loan balance is $200,000 but the death benefit is a million dollars. The death benefit would pay the $200,000 loan balance and leave the other $800,000 going to the beneficiaries of the policy.

Alex Murguia 34:57
There it is. Yeah. So.

Wade Pfau 35:00
So that's buffer assets.

Alex Murguia 35:03
Oh yeah. Did we get the whole Yeah? That was the last one. Yes. Buffer assets. There we go. All right, everyone, thank you for this episode. Listening in on this episode of retire with style. We'll be back next week with more mayhem and fun.

Wade Pfau 35:18
All right, catch you next time. Thanks, everyone.

Briana Corbin 35:23
Wade and Alex are both principals of McLean Asset Management and retirement researcher. Both are SEC registered investment advisors located in Tysons, Virginia. The opinions expressed in this program are for general informational and educational purposes only, and are not intended to provide specific advice or recommendations for any individual or on any specific securities to determine which investments may be appropriate for you consult your financial advisor. All investing comes with the risk, including Risk of Loss past performance does not guarantee future results. You