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Insuring an Education: A Surprising Way to Pay for College

529 Plans Aren't the Only Way to Fund an Education!

A record 72 percent of U.S. families are saving for their children's higher education, reports a 2016 study sponsored by Fidelity Investments. And in recent years, the primary vehicle for education saving has become the 529 plan. Although contributions to a 529 plan are not deductible, earnings in a 529 plan grow federal tax-free and will not be taxed when the money is taken out to pay for college.[1]

By the end of 2016, assets in 529 plans reached $275 billion, an increase of 8.6% over the previous year, according to a report from the College Savings Plans Network.

However, many wealth advisors and parents believe there is an alternative worthy of consideration when it comes to funding college. In this article, we examine the challenges with typical education funding strategies and explore why -- and how -- some people are utilizing whole life insurance in a variety of ways to solve those challenges.

So why are some parents bucking the trend and employing different solutions? Seven reasons stand out:

1. Financial Security.

529 plans offer different investment options, virtually all some form of index fund, mutual fund or target-date fund. Does anyone remember 2008? Or the dot com crash? These are the type of risks that some parents are not comfortable taking with their child's education fund.

Even "target date" funds inside 529 plans may not be as safe as perceived. After all, these types of education plans had significant losses during the 2007 – 2088 financial crisis, according to a CNBC.com report. While many age and date-based funds have been adjusted to taper out exposure to equities sooner, focusing on bonds and other slow-earning assets can become problematic when college expenses are considered.

Advisors and parents alike appreciate the guarantees of whole life insurance. In addition to the valuable death benefit it provides, whole life insurance comes with a number of living benefits.[2] In many policies, the cash value portion of the policy is *guaranteed*[3] to increase each year. In addition, the annual dividends (although not guaranteed) further increase policy values.[4] Which do you prefer... *saving* for college with the guarantees of whole life or *subjecting* your child's education fund to stock market risk?

The stability and predictability of the insurance industry is also attractive. When stocks suffered enormous losses in the aftermath of the sub-prime mortgage crisis, mutual life insurance companies continued to pay death claims and dividends to their policyholders without a hitch. A more conservative investment philosophy and liquidity requirements help to insulate mutual life insurance companies from some market risks and provide valuable diversification. The assets held by mutual insurance companies are managed by some of the best risk managers in the country.

2. Net vs Gross.

It is often said, it's not what you earn, but how much you keep that matters! This principle applies to investments as well as income. Many Americans are waking up to the impact of fees and other costs associated with their 529 plans. And in a falling market, fees can compound the losses!

In a September 20, 2016 CNBC.com article titled, "Commissions Are Devouring your 529 Earnings Gains," Darla Mercado warned, "Investors need to be aware of the internal expenses in these plans as well as the commissions advisors may receive for selling 529s. For instance, investors in certain portfolios can shell out an average of 4.75 percent in charges paid upfront to the advisor, according to fund research firm Morningstar."

According to Paul Curley of fund research firm Strategic Insight, some parents opt for self-directed 529 plans to avoid paying commissions. Yet these self-directed plans still have costs including "annual maintenance fees, fund fees and administration and management expenses."

Whole life has a guaranteed net value which accumulates tax-deferred. Of course, life insurance has commissions and fees as well, but the guaranteed cash value amount represents *net* gains, factored *after* all policy costs and commissions. Additionally, a paid-up addition rider[5] can help to build cash value more quickly.

3. Open-Ended Options.

Assets in college savings plans grow tax-free and can be withdrawn tax-free if used for qualifying educational costs. 529 savings plans can be used for a wide variety of expenses, such as tuition, books, room and board. However, there are also many restrictions on what the money can be used for. StudentLoanHero.com notes some of the expenses that *don't* qualify:

- Moving expenses to or from college, from a truck rental to room furnishings;
- Travel expenses to come home on school breaks;
- Transportation expenses such as a car, bus pass, subway or Uber;
- Insurance of all kinds, including car, health, and renter's insurance;
- Room furnishings;
- Student loan repayment; and
- Cell phone or electronic data plans.

Furthermore, as Joseph Hurley of SavingForCollege.com details in "Avoid These 529 Withdrawal Traps," parents must take heed to avoid withdrawing more than the school's cost estimates, paying the wrong entity, or not using up all of the funds in the plan.

And what if your child is fortunate enough to receive a scholarship or decides not to go to college, or does not complete college? What if they would rather start a business, circle the world as a travel blogger, or find an apprenticeship that doesn't qualify for college credit?

Parents face an interesting dilemma and tax consequences if they have only saved for college in vehicles that can only be used in specific situations for certain expenses. TheCollegeInvestor.com warns parents who may withdraw money from a 529 plan for unauthorized expenses or other reasons, "...**you'll have to pay federal taxes on the account earnings and a 10% penalty**. **If you've received a state tax break, you may also have to pay that back as well."**

Money from whole life isn't limited to supporting a child's education. The cash value of whole life can be used in an endless variety of ways. Buy a car or even a Condo/House for your child during college which can be rented out to fellow students as an investment. Want to fund a business launch, a mentorship program, or a down payment on a residence for the college graduate? No problem. While the cash value accumulates tax-deferred, you can also take tax-free dividends (up to the cost basis in the policy) during your retirement or use the cash value to fund your future grandchildren's college education. There are no restrictions on the use of money from whole life.

4. Leverage Your Assets.

An even more powerful use of whole life involves leveraging your assets. For instance, cash value can also be used as collateral to obtain bank loans at low competitive rates. (Don't try this with a 529 savings plan... it's not allowed!)

There are endless ways that cash value can be leveraged to the advantage of the policy owner or student.

A more leveraged way to use the cash value for the entrepreneurially-minded might be to:

- Borrow against the cash value for a down payment on a triplex or four-plex near your child's college.[6]
  - Your child lives in one unit while finding roommates to turn what would have been a college expense – housing – into a leveraged asset with cash-flow *and* built-in lessons in business, real estate, and responsibility!
  - Rather than coming away from college with a diploma and drained accounts, the family now has an asset that can continue to produce cash flow and gain equity.
  - Cash flow from the property pays back the property down payment, and, eventually, the mortgage and other expenses.

Now you have a college graduate *and* an additional asset!

5. Financial Flexibility for Savers.

What if parents or grandparents start saving for college when the child is young, but their financial situation changes before the child enters college? Perhaps a spouse passes or health deteriorates. Maybe they wish to fund their own business start-up after being downsized or to pursue a passion, but find their savings locked away in retirement plans or 529 savings plans that don't allow such flexibility.

Many parents and especially grandparents would like to contribute *more* towards college savings plans. However, it can be difficult to predict what expenses life may hold, or to contribute aggressively to savings plans that offer little flexibility. As important as college can be, it is even more important that the college student does not end up supporting their parents or grandparents someday! So, it is essential that college fund contributors are also safeguarding their own financial stability.

Whole life gives the policy owner ultimate financial flexibility. It's an emergency fund, an opportunity fund, it can be used to supplement retirement[7], replace the roof... yes, even pay for college tuition!

6. Maximize Financial Aid.

Another motivator for parents to consider using whole life instead of a 529 plan is this: when a student applies for financial aid through submitting a FAFSA[8], the assets in a 529 plan owned by them or their custodial parents are counted against them, potentially decreasing the amount of financial aid they will qualify for.

Additionally, grandparents and non-custodial parents have a rude awakening when the student applies for financial aid the second year. While the initial FAFSA application won't consider the assets of a grandparent or non-custodial parent in determining the first year's financial aid, that changes after the first year when money from those 529 plans is utilized. As Amy Feldman reports in a Reuters.com article, "...as the money is withdrawn to pay for tuition or other educational expenses, that amount must be reported on the next year's financial aid forms as untaxed income to the student, and it can reduce the amount of aid by 50 percent."

Whole life cash value is not counted as an asset on a FAFSA application, regardless of who owns the policy. This knowledge can help a student qualify for more financial aid than if the same assets were in a 529 plan. However, consider using loans from the whole life policy instead of withdrawals unless it is the last year of college, because withdrawals are considered to be "income" and can reduce financial aid the following year just as a 529 plan withdrawal would.

7. A Great Way to Plan for the Unexpected.

What would happen in the event that a parent or grandparent should pass unexpectedly while in process of saving for college? Without life insurance, their plan might fail. With whole life insurance, the policy’s death benefit can complete the goal of funding the child’s college education.

In addition, a "Waiver of Premium" rider can be added to the whole life policy for a nominal additional premium, which provides that the insurance company will continue to pay the full annual premium if the insured became disabled. Either way, if there is premature death or a disability of the insured, funds are still available for the child goes to college.

529 Plans are solely dependent on contributions and how well the market performs. The real question is...will there be a "market correction" during the college years or worse, the summer before freshman year? Quite a scary scenario.

A College Plan That Works

With college costs rising to new highs, the question of how best to pay for college has never been more important. The College Board reports that a "moderate" college budget for a private college averages $49,320 for the 2016-2017 year, double the still-significant cost of an in-state public college at an average of $24,610. Educating just one child can be a six-figure commitment, if not multiple six figures for students attending traditional 4-year universities. (And that's before opportunity costs are calculated!)

Whole life is not a "quick fix" solution and it's not a good savings strategy if your child is 15 and you need an instant return on your money. But it is a solution especially appreciated by parents and grandparents who take a long-term view of planning. Additionally, whole life can be a tremendous help in improving the family's financial position, as well as a way to fund college with maximum flexibility and security.

[1] Guardian, its subsidiaries, agents, and employees do not provide tax, legal, or accounting advice. Consult your tax, legal, or accounting professional regarding your individual situation.

[2] Whole life insurance is intended to provide death benefit protection for an individual's entire life. With payment of the required guaranteed premiums, you will receive a guaranteed death benefit and guaranteed cash values inside the policy. Whole life insurance should be considered for its long-term value. Early cash value accumulation and early payment of dividends depend upon policy type and/or policy design, and cash value accumulation is offset by insurance and company expenses.

[3] All whole life insurance policy guarantees are subject to the timely payment of all required premiums and the claims paying ability of the issuing insurance company. Policy loans and withdrawals affect the guarantees by reducing the policy's death benefit and cash values.

[4] Dividends are not guaranteed. They are declared annually by Guardian's Board of Directors.

[5] Whole life riders may incur either an additional premium or cost. Riders may not be available in all states.

[6] Policy benefits are reduced by any outstanding loan or loan interest and/or withdrawals. Dividends, if any, are affected by policy loans and loan interest. Withdrawals above the cost basis may result in taxable ordinary income. If the policy lapses, or is surrendered, any outstanding loans considered gain in the policy may be subject to ordinary income taxes. If the policy is a Modified Endowment Contract (MEC), loans are treated like withdrawals, but as gain first, subject to ordinary income taxes. If the policy owner is under 59 ½, any taxable withdrawal may also be subject to a 10% federal tax penalty.

[7] This Material is Intended for General Public Use. By providing this material, we are not undertaking to provide investment advice for any specific individual or situation, or to otherwise act in a fiduciary capacity.

[8] Free Application for Federal Student Aid

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