Life Insurance Overview

Disclaimers

- The information in this material is not intended as tax or legal advice. Please consult legal or tax professionals for specific information regarding your individual situation.
- Clients are encouraged to talk to licensed insurance professionals for specific policy recommendations and details.
- The content herein was developed from sources believed to be providing accurate information.
- All investing is subject to risk, including the possible loss of the money you invest.
- All final investment and planning decisions are the discretion of the client.

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What is Life Insurance?

In simple terms, life insurance is a contract in which the insurance policy owner makes regular payments — also known as premiums — to an insurance company. In return, the insurance company pays a lump sum of money to the policy’s named beneficiaries if the insured party dies while the policy is active.

The life insurance company performs extensive analysis on projected lifetimes, health risks, investment returns and other factors to define the premiums required. Some of the other factors related to the insured party include age, gender, occupation, and home location.

Purposes of Life Insurance

1. Replace the income of a primary earner in case of their death.
2. Cover ongoing expenses that would have been paid via the deceased’s income.
   A. Family living expenses.
   B. Higher education savings.
   C. Support of aging parents or grown children with special needs.
3. Fund the Long-term retirement needs of a surviving spouse.
4. Pay off debts owed by the deceased that are in excess of the deceased’s liquid assets.
5. Provide funds to pay for interim costs in the case of Probate.
   A. Use the insurance policy proceeds to cover mortgage, loan, tax and other recurring costs of the deceased’s estate.
   B. Pay for the legal costs associated with the probate process.
6. Use Cash-Value life policies to build retirement savings.
7. Use Term life policies to cover key employees of a business and to fund the buyout of a deceased co-owner’s shares.

Terms and Definitions

1. Insurance — a contracted financial structure in which risk is transferred to an insurer, tied to a promise to pay, in return for equitable premiums. Insurance is used to transfer a large amount of individual risk across a wide pool of insured parties.
2. Life Insurance — a form of insurance that provides economic protection to those who would suffer financially if the insured party died.
3. Insurer — a person or company that contracts to pay another party in the event of loss or damage.
4. Insured — the person whose life is covered by the life insurance policy. May be different than the policy owner.
5. Policy Owner — the person holding the contract with the insurer and making premium payments for the policy.
6. Policy Beneficiary — the person or entity that receives the death benefit upon the death of the insured.
7. Policy Period — the interval of time during which the insurance policy is in effect.
8. Premium — the payments made to keep a life insurance policy active. May be level or variable amounts.
9. Death Benefit — the sum of money paid to the beneficiary upon the death of the insured. Also called the Face Amount.
10. Cash Value — the amount of money that has accrued in certain insurance policies. May be paid to the policy holder if the policy is cancelled or can be used as a loan.

Terms and Definitions

11. Rider — an extra provision that can be added to an insurance policy. Riders add more coverage in exchange for increased premium cost. Riders allow people to customize their insurance policies so they can pick and choose benefits they want while not paying for benefits they don't want.

12. Settlement Option — defines how the proceeds of the insurance policy will be paid. This is typically established by the policy owner, and may be a lump-sum payment, installment payments over a fixed period or of a fixed amount, or various income-for-life options.

13. Surrender — cancellation of a life insurance policy.

14. Evidence of Insurability — statement or proof of the insured's health, finances or job, which helps the insurer decide if they are an acceptable risk for life insurance.

15. Underwriting — the process used to assess eligibility to purchase insurance and the insured's risk classification.

16. Agent — state-licensed insurance company representative who solicits and negotiates insurance contracts and provides service to the policyholder on behalf of the insurer. An agent can be independent (represents at least two insurance companies) or a direct agent who represents and sells policies for only one company.

17. Life Expectancy — probability of an individual living to a certain age.

18. Needs Determination — the process used to calculate the death benefit amount needed to cover the immediate and projected expenses that the deceased's earned income would have covered.

Interesting Facts re: Life Insurance

1. 50% of Americans have some form of life insurance.
2. The percentage of Americans with life insurance has declined by about 13% over the past decade.
3. 59% of married Americans have life insurance; 38% of single Americans have life insurance.
4. 59% of insured individuals purchased their own policy; 23% have coverage via employer; 18% have both.
5. Women are twice as likely (22%) as men (11%) to lack life insurance.
6. Only 34% of GenZ own life insurance policies; 57% of Baby Boomers own life insurance.
7. 44% of American households would encounter significant financial hardship within 6 months is the primary wage earner died; 28% would reach that point within a month; 10% within one week.
8. Factors taken into account when life insurance policies are offered: age, gender, health history, driving record, criminal record, credit history.
9. 50% of respondents to a Forbes survey cited uncertainty about the type or amount of life insurance to buy as the primary reason for lack of personal policies. 49% report cost as the primary reason.
10. Disability is a greater risk than death for most individuals. A 30-year-old is 4x more likely to be permanently disabled than die before they reach 65 years of age. This ratio is 2.7x for a 40-year-old.

Cited from sources including Forbes, annuity.org, and others.

Types of Life Insurance

- Life Insurance
  - Term Life
    - Annual Renewable
    - Level Premium
    - Decreasing Term
  - Permanent Cash Value
    - Whole Life
    - Universal Life
    - Variable Life
    - Variable Universal Life

Term Life

✓ Coverage for a defined period
✓ No cash value accumulation
✓ Less expensive

Permanent Cash Value

✓ Coverage for life of policyholder
✓ Accumulates cash value
✓ More expensive than Term Life
✓ Investment options

Life Insurance Features and Suitability

Type	Features	Target Clients
Term	Provides coverage for a specified # years (term). No cash value accumulation. Least expensive.	Self-employed, Employees in between jobs, Non-working spouses, Business owners
Whole	Permanent coverage, fixed premiums, fixed death benefit, and guaranteed minimum cash value.	Younger people. Candidates for Term Life looking to accumulate modest cash value as part of long-term savings plan.
Universal	Permanent coverage, flexible premiums, adjustable death benefit, accumulated cash value.	Young couples, due to flexibility with premiums and death benefits as life status changes. Newborns: cash value appreciation and guarantee of future coverage regardless of health.
Variable	Permanent coverage, fixed premiums, guaranteed minimum death benefit, owner-directed cash value investments.	Individuals interested in Whole Life who are willing to take risk with accumulated cash value in order to get better returns.
Variable Universal	Permanent coverage, flexible premiums, adjustable death benefit, owner-directed cash value investments.	VUL policyholders want premium and death benefit flexibility as their situation changes and are willing to take risk to increase cash value appreciation potential.

Key Factors to Consider

1. Is life insurance needed? i.e., is someone dependent on the insured's future income?
2. Needs determination – calculation of the amount of income that needs to be replaced via the insurance policy proceeds.
   - A RULE-OF-THUMB OFTEN CITED IS TO BUY LIFE INSURANCE WITH A DEATH BENEFIT EQUAL TO 6-10X YOUR ANNUAL INCOME. LIKE MANY "RULES OF THUMB", THIS IS OVERSIMPLIFIED, AND WE WILL COVER A MORE-DETAILED PROCESS FOR DETERMINING YOUR LIFE INSURANCE NEEDS.
3. Timeframe over which life insurance coverage is needed (term).
4. The Insured's life insurance (and disability) coverage via their employer.
5. Available budget for life insurance premiums.
6. The person(s) designated as beneficiaries.
7. Does the insured want to use their insurance policy as a vehicle for long-term savings?
8. Price differences for comparable coverage by different insurers. Shop around.

How Much Life Insurance Do I Need?

The Life Insurance Coverage you need is typically calculated in **three** steps:

Step 1: Determine immediate cash needs at time of death.

Step 2: Estimate the funds needed to maintain the survivors' lifestyles over time.

Step 3: Combine the amounts from Steps (1) and (2) to define the Life Insurance Coverage Amount needed.

Step 1: Calculate **Immediate_Cash_Needed**

A. Using a Balance Sheet, define the Insured's Assets and Liabilities. Separate Liquid and Illiquid Assets.

B. Confirm any bequests the Insured has committed to upon their death.

C. **Immediate_Cash_Needed** equals (Debts + Expenses + Cash Bequests) MINUS (Available Liquid Assets).

Step 2: estimate the **Long_Term_Funds_Needed** to Maintain Survivors' Lifestyles

A. This is best performed via a spreadsheet, listing the projected expense types as separate rows and the columns representing the future timeline.

B. Projected expenses can be broken into two categories: living expenses and higher education / special expenses.

C. The projected timeline should run until the Survivors are no longer dependent on the Insured's income. The total of all defined expenses over this timeline is the **Long_Term_Funds_Needed**.

Step 3: Calculate the total amount of Life Insurance Needed

The Life Insurance Coverage Amount should be equal to or greater than the sum of the Immediate Cash Needed and Long-Term Funds Needed.

Example – Young, Unmarried Individual

Recent college graduate, student loans co-signed by parents, renter, employer offers life/disability coverage, no siblings.

Decision factors:

- Is someone dependent on the insured's future income? Potential long-term care for parents.
- Employer coverage. This coverage will lapse if employment ends, and during job transitions.
- Does the employer's life coverage exceed the insured's debt obligations? Don't put the burden of paying off student loans on parents.
- Coverage duration. Based on employment security and future plans (marriage, family), consideration of a permanent policy with cash value accumulation or a term policy with conversion rider is warranted.
- Long-term savings potential and discipline. If the individual doesn't have a structured savings program, a Variable policy may be applicable vs. Term coverage.

Example – Married Couple, No Children

One income earner (wife), homeowners, employer offers life/disability coverage, plan to start a family.

<u>Decision factors</u>:

- Is someone dependent on the insured's future income? Yes – <u>both</u> spouses should have coverage.
- Employer coverage. This coverage will lapse if employment ends, and during job transitions.
- Does the employer's life coverage meet Needs Determination results? Probably not, accounting for mortgage balance, property taxes, various loans (car, student). Additional coverage needed.
- Coverage duration. Based on employment security and future plans (family, college education), consideration of a permanent policy with cash value accumulation or a term policy with conversion rider is warranted.
- Long-term savings potential and discipline. Most $-efficient model is to buy Term and invest any budget surplus in a simple growth portfolio of stock/bond funds.

Example – Married Couple, w/ Children

Dual income earners, homeowners, employers offer life/disability coverage, two young children.

<u>Decision factors</u>:

- Is someone dependent on the insured's future income? Yes – <u>both</u> spouses should have coverage.
- Employer coverage. This coverage will lapse if employment ends, and during job transitions. Key consideration if either spouse plans to be a stay-at-home parent.
- Does the employer's life coverage meet Needs Determination results? Probably not, accounting for home costs, loans, higher education plans, childcare and long-term savings needs. Additional coverage needed.
- Coverage duration. Based on employment and family needs (childcare, college education), additional coverage above the employer's coverage will be required. A term policy with a conversion rider or a permanent policy with cash value accumulation should be considered.
- Long-term savings potential and discipline. Most $-efficient model is to buy Term and invest any budget surplus in a simple growth portfolio of stock/bond funds.

Example – Middle-Aged, Empty Nest Couple

One primary income earner (husband), homeowners, employer offers life/disability coverage, significant expenses re: weddings, college, child support in recent years has reduced assets.

Decision factors:

- Is someone dependent on the insured's future income? Yes – the wife.
- Employer coverage. This coverage will lapse if employment ends, and during job transitions. Key consideration if the husband changes jobs or loses job.
- Coverage duration. New insurance policies will be significantly more expensive at age 40+.
  - Needs Determination exercise can guide use of Term Life as lowest-cost option.
  - Interest in Long-Term Care rider may sway decision to Permanent Life policy.
- Long-term savings potential.
  - Most $-efficient model is to buy Term with a policy period and invest any budget surplus in a simple growth portfolio of stock/bond funds.
  - Interest in Long-Term Care rider may sway decision to Permanent Life policy.
- Estate Planning. Cover probate costs and asset maintenance; boost inheritance amounts.

Example – Post-Retirement

Significant assets, Social Security and RMDs meet expenses, homeowners with no debt.

<u>Scenario 1 – couple has existing Term Life policies</u>

- Due to increased premium costs, they may consider a term conversion or let the policy lapse due to availability of assets to meet life expense needs.
- Estate planning factors may dictate continued coverage.

<u>Scenario 2 – couple has existing Permanent Life policies</u>

- Based on policy contract, the accumulated Cash Value may be used to fund future premiums, long-term care needs, or allowed to continue to appreciate.

<u>Scenario 3 – couple has no established life insurance coverage</u>

- New life insurance policies will be very expensive. Unless desired for estate planning purposes, a new policy is likely unnecessary.

Example – Private Business Owner

Business owner has two partners, is married (spouse has no role in business).

<u>Life Insurance Usage in Conjunction with Business Ownership Agreement</u>

1. The business buys separate life insurance policies for each owner, in excess of the value of that owner's share of the business.   The business is named as beneficiary of the policy.
2. In the case of the death of any owner, the proceeds are used by the company to:
   A. Buy the deceased's owner's equity, at the valuation established in the Agreement, and
   B. Use the excess policy proceeds to cover expenses related to the loss of the owner (hiring a replacement, etc.).
3. In this case, the business' ownership agreement should specify the valuation technique, buy-out conditions in the case of the death (or disability) of any owner, and be signed by each owners' spouse in recognition of their agreement to sell the deceased spouse's equity per the agreement.
4. If the owner is NOT married, the owner's agreement can be adjusted to ensure the owner agrees to have his estate sell the equity back to the business at the established valuation.

Ongoing Life Insurance Management

1. As part of an annual financial plan assessment, we recommend all clients assess their insurance coverage and estate planning documents.
2. Other life events that warrant an assessment of life insurance coverage:
   A. Job loss or transition (employer's life insurance coverage will lapse).
   B. Family changes (marriage, divorce, new child, emptying of nest).
   C. Significant inheritance (reduces need for life insurance).
   D. Retirement.
   E. Estate plan changes.
3. The core of every re-assessment is to recalculate how much life insurance is needed via the process discussed earlier and ensure that ample coverage is in place.
4. If additional coverage is needed, assess the cost of an increase in your existing policy's death benefit vs. adding a new policy to close the gap.

Resources

1. www.investopedia.com – this is a great resource for financial, tax and estate related topics.
2. Kaplan College for Financial Planning AAMS® Course Study Material.
3. STC Series65 Exam Course Study Material.
4. https://www.policygenius.com/life-insurance/life-insurance-calculator/
5. https://www.nerdwallet.com/article/insurance/types-of-life-insurance
6. https://www.policygenius.com/life-insurance/how-to-buy-life-insurance/
7. https://trustandwill.com/learn/life-insurance-beneficiary-vs-will

Questions?