PenFacs

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Life Insurance as an Asset and Risk Management Tool

Life Insurance can be a part of a diversified plan to manage risks in family, business, retirement and estate planning. Life insurance is an asset guaranteeing death benefits to satisfy several goals including:

- Paying estate settlement costs
- Providing for children and/or grandchildren with special needs
- Providing business continuation plan funding
- Providing family protection and income needs
- Providing for specific needs such as mortgage payment, college education, divorce requirements, equalizing an estate among children, and charitable bequests
- Compensating for the loss of a key person while at the same time funding a retirement benefit for a key person at normal retirement age
- Maximizing retirement income from retirement benefit plans while protecting family members if the retiree dies early.
- Providing asset transfer enhancement in conjunction with IRA distribution planning
- Providing a "bond replacement" asset in a balanced portfolio of a wealthy client

Life insurance also can be used for living needs such as:

- Supplementing retirement income: a Life Insurance Retirement Plan (LIRP) provides death protection before retirement and at retirement provides an income stream for a period of years.
- Riders on certain life insurance policies provide funds for critical illness, nursing home care, terminal illness, return of premiums, and benefits for children.

Types of Life Insurance:

Term Insurance: Temporary needs are usually best solved with temporary insurance that ends at a defined time. Temporary insurance can be 10, 15, 20, 25, or 30 year term insurance. Premiums for term insurance are less than permanent insurance. Some term insurance policies provide conversion benefits that allow the insured without medical underwriting to exchange a term policy for a permanent policy. Some term policies have "return of premium" benefits that provide a return of premiums paid if the insured survives the term period. These policies also offer a paid up insurance option which provides a lifetime guaranteed death benefit without any further premiums.

Permanent Lifetime Insurance:

Lifetime needs are usually best solved with permanent insurance. There are many types of permanent life insurance. Some of the types include:

- **Universal Life with "no lapse guarantees":**
    - No lapse guarantees can be lifetime guarantees, or guarantees that are less than lifetime. Premiums and benefits can be adjusted within limits providing flexibility.
    - Universal Life policies that have limited no lapse guarantees often will provide higher death benefits per dollar of premium as compared with lifetime no lapse policies. With limited guaranteed no lapse coverage, lifetime continuation of death benefits is conditioned on the investment, mortality, and the expense charges experienced while the policy is in force. Waiting to take corrective action for poor performance can cause a more expensive solution to avoid lapse of a policy with limited no lapse guarantees.

- Universal Life policies have premium flexibility. The three types are fixed, indexed, or variable. Each type has non-guaranteed current and maximum guaranteed mortality and expense charges. How investment returns are earned is a key difference:
  - The investment return for fixed universal life (**UL**) policies has a minimum guarantee rate as well as a current rate. The current rate is determined by the returns on the general assets of the insurance company.
  - The investment return for indexed universal life **(IUL)** policies includes the greater of a minimum guarantee and a rate determined by market indexes. The market indexed rate is usually capped with a maximum period rate. IUL policy guaranteed no lapse period is usually performance dependent.
  - Investment returns for variable universal life **(VUL)** policies are determined by returns of separate accounts selected by the owner. Performance of selected separate accounts affects living and death benefits over the guarantees.
  - **UL, IUL, or VUL** can have <u>lifetime or limited guarantee no lapse coverage</u>. During the no lapse coverage period the death benefit will be maintained for the "no lapse" premium regardless of investment performance, mortality experience, and expense charges for the policy. So, in those cases where there is no cash value (performance is less than illustrated), the death benefit can be continued as long as the premiums are paid on time during the "no lapse" period. Understand the non-guaranteed and guaranteed values and premiums.

- **<u>Whole Life Policies</u>**
  - Whole Life **(WL)** Policies have been available for many years. WL premiums have fixed premiums based on the policy's guarantees for interest, mortality and expense charges. Improvements over the guaranteed assumptions can produce a dividend to the policyholder. Dividends can be used for many uses including reducing premiums, increasing cash value and death benefits ("Paid-Up Additions"), and purchasing term insurance to provide temporary increased death benefits.
  - With WL, changing or skipping premiums can be accomplished using surrender of dividends or cash value loans. Decreasing death benefits to reduce premiums is not usually available with WL. Loans require interest and a reduction of net death benefits.
  - A permanent WL policy often is coupled with a temporary term rider to reduce premiums for a given death benefit. The premium and the projected (non-guaranteed) dividends pay for the term rider and "Paid-Up Additions". As long as the dividends continue as projected, the illustration shows a level death benefit for life for the given premium. However, if dividends do not materialize as originally illustrated, the death benefit will not continue for the given premium.

UL, IUL, and VUL are more flexible, costs and returns are more transparent than WL. The interplay of investment return, mortality, and expense charges are bundled within WL. WL premiums are guaranteed for the base WL policy. Term mixes are not guaranteed and are usually dividend dependent.

It is important to understand how long UL, IUL, and VUL guarantees last. UL, IUL, and VUL may not have guarantees for premium and death benefit continuation. <u>Lifetime</u> no lapse guarantees on UL, IUL, or VUL produces a premium that will continue the policy in force for life regardless of investment, mortality, or charges experienced during the life of the policy. Limited no lapse guarantees provide for the same guarantees only during the limited specified no lapse period for the specified premium.

Riders providing cash for critical illness, long term care, terminal illness, return of premium and longevity can add living benefits to life insurance policies.