An Overview of Life Insurance

Life insurance is the foundation of financial security and wealth management for you and your family. It protects your financial resources against the uncertainties of life and provides transition assistance of your assets to the next generation. Choosing a life insurance product is an important decision, but it can be complicated. The life insurance industry has changed dramatically over the last decade. Products are now more complex, competitive and creative; life insurance companies are a division of large financial service conglomerates and buyers are now educated and sophisticated.

Life insurance provides payment of a death benefit at the death of the insured(s). However, life insurance has many unique characteristics that may make it an appropriate solution for a variety of uses in addition to the death benefit protection. Some of these characteristics include:

- Policy cash values accumulate on a tax-deferred basis.
- Policy death benefits are received income tax-free.
- Policy cash values may be accessed on a tax advantaged basis. Please keep in mind loans and partial withdrawals may decrease the death benefit and cash value and may be subject to policy limitations and income tax.

Although often mistakenly viewed as only a cost and price decision, the long term nature of life insurance necessitates careful consideration in the selection of the insurance carrier, the product type and the agent or agency to represent you and interact with your heirs. Some of the questions to consider in purchase include:

- Does the agent have a business succession plan that provides for continued service after the retirement or death of the original agent?
- Does the agent have sufficient experience to meet your needs adequately?
- Does the agent have any influence with the carrier selected?
- Is the insurance carrier financially sound?
- Does the carrier have a history of equitable treatment of existing policyholders?
- Will the service levels provided by the carrier satisfy your requirements?
- Will the product be able to adapt to changes in your personal and financial goals or situation?
- Are the pricing assumptions of the product economically sound?
- If a term purchase, what products are available if conversion occurs? Are these products comparable to the current marketplace?

Getting the answers to these questions highlights the many strengths of working with The Wealth Design Center.

Purposes of Life Insurance

Life insurance is used in many personal, business and charitable contexts. Some of the most common uses of life insurance are:

Business

- Key Employee: provide funds to aid in the search for a replacement in the event of death of a key employee.
- Executive Recruitment and Retention: used to provide a variety of non-qualified benefit programs to help attract and retain key employees.
- Business Continuation: provide funds to aid in the continuation of business in the event of death of a key revenue generator
- Succession Planning: provides liquidity to purchase the ownership interest of a deceased owner.
- Debt Protection: creates a pool of money that can be used to pay off lines of credit.

Personal

- Family Protection: provides a source of cash for surviving family members to utilize for living expenses.
- College Funding: provides a funding source for college education of children or grandchildren.
- Debt Protection: generates cash to pay off an existing mortgage or other personal debt.
- Wealth Creation: provides funds to leave as an inheritance or to equalize inheritances among family members.
- Estate Tax Liquidity: creates liquidity to pay estate taxes rather than requiring liquidation of existing estate assets.
- Gifting Leverage: leverages the use of the annual gift tax exclusion, the applicable exclusion, and/or Generation Skipping Transfer Tax exemption.

Charitable

- Wealth Replacement: used with many charitable gifting programs to replace for heirs the value of estate assets that were gifted to charity.
- Gift Creation: used to create a significant donation to charity at death.
- Gift Leverage: used to maximize the eventual charitable donation at the death of the insured.

Types of Life Insurance

Term – Provides death benefit coverage for a specified time period. Premiums may increase annually (annual renewable term) or remain level for period of time (e.g. 10 years) before increasing. Typically provides the lowest initial cost, but the highest long term cost for coverage. Policies may be convertible to a permanent insurance policy for a limited period of time from as little as 2 years to possibly as late as age 65. Term insurance differs from permanent insurance in that term insurance does not accumulate cash value while permanent coverage has a cash value component.

Whole Life – Permanent death benefit coverage characterized by strong guarantees and premium payments until death of the insured. A purchaser of whole life typically sacrifices premium flexibility for the guarantees found in the contract. If the premium is paid as scheduled, the death benefit is guaranteed. Deviation from the premium schedule normally results in loss of the death benefit guarantee. Premiums for whole life are normally the most expensive compared to the other policy types.

Universal Life – Permanent death benefit coverage recognized for its premium flexibility and cash value accumulation. The amount and timing of premium payments is flexible as long as policy cash values are sufficient to pay for the cost of insurance coverage. Typical death benefits options available include a level death benefit or an increasing death benefit. The increasing death benefit is usually a level amount plus either an amount equal to the cash value of the policy or an amount equal to the cumulative premium payments. When initially introduced, universal life insurance did not offer guarantees comparable to whole life contracts. However, in recent years many policies have begun to offer competitive death benefit guarantees if a minimum premium amount is satisfied. Of course, death benefit guarantees are dependent on the claims paying ability of the insurance company.

Variable Universal Life – Permanent death benefit coverage where the policy owner directs investment of policy cash values into various investment options called sub-accounts. Maintains the core characteristics of universal life, but shifts the investment risk and control from the life insurance carrier to the policy owner. The policy potentially allows for greater cash value accumulation but with a significantly higher level of risk than is found with other types of cash value life insurance. Variable Universal Life is long term investment normally suitable for clients with investment experience, a higher level of risk tolerance, and the financial resources to withstand investment fluctuations, including the possible loss of principal.
Coverage Types

Single Life Coverage – This coverage provides death benefit protection on the life of one insured. Policy proceeds are payable at the death of the insured. This coverage is used for a variety of concepts.

Joint Life Coverage – Also known as second-to-die and survivorship life insurance, this coverage provides death benefit protection on two insureds. Policy proceeds are payable at the second death of the two insureds. This coverage is typically utilized in an estate planning context where use of the unlimited marital deduction allows estate tax to be avoided at the first death with the tax paid at the second death.

First-to-Die Coverage – This coverage provides death benefit protection on a small group of insureds. Policy proceeds are payable at the first death among the group. Typically purchased only in a business situation for buyout of an ownership interest at death, first-to-die coverage availability has been on the decline in recent years due to its complexity and the increased affordability of other coverage types.