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LIFE INSURANCE: A KEY COMPONENT OF A FINANCIAL PLAN

If asked what comes to mind when thinking of financial planning, many would likely mention topics such as saving for retirement, planning for college, creating strategies for retirement income, or structuring a portfolio with an eye toward maximizing tax efficiency. Indeed, planning for our later years, or saving to accomplish certain goals, tend to be the primary focus for many in financial planning. Equally important, we believe, is the importance of incorporating life insurance strategies into a financial plan that will address specific needs such as providing for loved ones, or ensuring a business' continuity, if and when one is gone.

Life Insurance: The Major Types

When considering life insurance, there are essentially two types: permanent, and term. Broadly speaking, permanent policies are designed to cover the insured over his or her lifetime, while term policies provide coverage that spans a specified time period. Regardless of whether one chooses term or permanent coverage, however, the death benefit bypasses time consuming probate proceedings, and typically passes directly to the insured's beneficiaries free of income taxes.

Term insurance can be categorized as "group term"- low cost insurance offered to a group of individuals, such as the employees of a company or business, or "individual term"- coverage that is purchased by an individual for a certain period of time such as 5, 10 or 15 years. Given that term policies are designed to provide a death benefit only, term insurance is typically less expensive, at least initially, compared to permanent policies. Once the term expires, however, any renewal of the policy will typically be met with an increase in premiums.

In contrast to term insurance, permanent policies are designed to provide a lifetime of coverage, with the two main types of permanent insurance being "whole life," and "universal life." With whole life policies, annual premium costs are initially higher than those of term policies, but they remain constant over the life of the policy. Furthermore, in addition to covering the insurance cost that provides for the policy's death benefit, a savings component of the premium payments helps to build cash value over time. As with other savings vehicles, the cash value of whole life policies earns interest, and does so on a tax deferred basis. Also, depending on the policy, the cash value may be withdrawn or taken out in the form of a policy loan for things like college tuition, home improvements or retirement income.

With universal life, policyholders may enjoy some extra flexibility with respect to the premiums, or the face value of the policy. For example, premium payments can be increased, decreased or possibly deferred, while also building cash value over time. Similarly, universal life policyholders may have the option of changing the death benefit of the policy as needs or circumstances change.

Who Needs It and Why?

While life insurance may not be appropriate for everyone, we believe it offers value to many including:

Individuals with a spouse or children that rely on them for financial support. Perhaps the most important benefit of life insurance is its power to replace the income of a family breadwinner in order to help maintain the family's current lifestyle. When considering how much insurance to carry, consider factors such as current and future income needs, as well as future expenses such as college tuition.

Those seeking to cover the cost of final expenses. While most may choose to avoid thinking about their own passing, some basic planning for final expenses may help one's heirs to better navigate, financially, during what will likely be a difficult time. With proper planning, life insurance can help cover the cost of final expenses such as funeral costs, outstanding medical bills, or estate taxes, such that surviving family members can avoid spending savings that was planned for other uses.

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Individuals with a joint mortgage or other significant debt. For those who have a joint mortgage or other large debt, life insurance may prove invaluable to a surviving borrower. In the absence of coverage, the survivor may find him or herself in the position of having to sell the home or other assets, perhaps at a discount, in order to pay off the outstanding debt.

Business owners. Life insurance can also play a role in helping a business owner to leave his or her estate to the children in a manner that all might consider fair and equitable. For example, a business owner may have children involved in running the family business, as well as others who have chosen to pursue other professions. Logically, the owner may want to leave the business to the children who were involved in its management so that they can continue to derive benefit from it. In order to provide for the children who were not involved in the business, the owner may choose to purchase a life insurance policy that carries a death benefit that's similar in value to that of the business, and name these children as the beneficiaries on the policy. In this way, all of the children would receive assets of approximately equal value upon the owner's passing.

Yet another way that life insurance may benefit business owners is in business partnership situations. In order to help ensure that a surviving partner could afford to buy out a partner's heirs in the event of his or her passing, each of the partners may wish to hold an insurance policy on the life of the other.

As a Tool for Planning

While life insurance is likely thought of, first and foremost, as a vehicle to provide a death benefit, it can also play a role in areas such as charitable giving or long term care planning. For example, if one donates regularly to a favorite charity, the charity could use the donated funds to purchase a life insurance policy on the donor. By purchasing a policy on the donor's life, the charity is positioned to receive a death benefit that may far exceed the value of the donations received once the donor eventually passes. Similarly, through regular charitable giving, the donor is able to continue to enjoy the tax benefits over the remainder of his or her lifetime.

With respect to long term care planning, life insurance can play a very important role. Traditionally, long term care policies would only pay out a claim if one became ill and needed care. If the individual were to live a long healthy life, and then died suddenly, all of those long term care premiums would be gone. Fortunately, many of today's permanent life insurance policies give the option of using the death benefit for qualified long term care expenses while the person is living. If the insured needs long term care, the "living benefit" will pay for the care, thereby protecting other assets. If he or she pass away without needing care, the death benefit will be paid to the chosen beneficiary.

While, on the surface, life insurance may seem a fairly simple and straightforward vehicle designed to help provide for one's heirs when he or she is gone, we believe that when used correctly, it can be a valuable component of one's overall financial plan. Please contact us if you have questions as to whether life insurance is right for you, or if you have questions about an adequate level of coverage. Similarly, we're happy to review any existing policies that you may have to help ensure that they are adequately meeting your personal protection needs.