Important Facts You Should Know

Before Buying Life Insurance

RETIREVO

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Introduction to Life Insurance

In its most simple definition, a life insurance policy is a contract made between an insurance company and the insurance policy holder. In exchange for premium payments on a set schedule, the insurance company provides a lump-sum payment, known as a death benefit, to beneficiaries upon the insured's death.

People buy life insurance for many reasons, including:

- income replacement
- mortgage protection
- supplemental retirement income
- liquidity for future tax liability
- funeral and burial costs
- covering the loss of a business' key staff member(s)
- diversify investments

✓ LIFE INSURANCE IS FINANCIAL PROTECTION.

Life Insurance comes in many different forms and what you choose for protection should be in line with your goals.

A life insurance policy is chosen based on the specific needs and goals of the owner. There are a variety of life insurance types available to consumers today, the most popular being term and permanent life insurance. Term life insurance generally provides protection for a set period of time, while permanent insurance (such as whole and universal life) provides lifetime coverage.

Life insurance is financial protection

In the event of a premature death, a life insurance policy provides liquid resources your loved ones may need to pay immediate and continuing expenses. For those who live a long life, the cash value in life insurance could be available as a source of additional retirement income for their golden years. Ultimately, the goal of life insurance is to ensure that one's accumulated wealth remains useful to their family and their goals—not spent on avoidable taxes or mismanaged after they pass on.

One of the most attractive features of life insurance policies is that they are adaptable. Life insurance policies can provide immediate protection upon purchase of a policy and later evolve as needs change. Therefore, choosing the right type of life insurance and selecting the correct policy is an important decision that requires basic knowledge and sound planning.

$ TAX FREE BENEFITS

Note that death benefits from all types of life insurance are generally income tax-free, which helps secure your wealth for the future.

Life Insurance Marketing and Research Association (LIMRA) conducts an annual Life Insurance Barometer Study which tracks the financial perceptions, attitudes, and behaviors of adult consumers. Their 2021 analysis identified financial trends as well as misconceptions that keep Americans from achieving the financial security that life insurance can help provide.[i]

♦ LIMRA 2021 BAROMETER HIGHLIGHTS

• Overall financial concerns rose 20 percent over the last 2 years.[i]

• While Life insurance market penetration is 11 points below the 2011 high of 63%, the COVID-19 pandemic has increased consumer interest in Life Insurance, with 31% of uninsured saying they are likely to buy because of the pandemic.[i]

• If a household's wage earner died unexpectedly, 25% of those surveyed said they would face financial hardship within a month, and an additional 17% would face financial hardship within 6 months.[i]

• Consumers overestimate the cost of life insurance. This is especially true for Millennials, where 44% overestimate the cost of a The cost of a term life insurance for a healthy 30-year-old (priced around $160 per year) as more than 6 times higher, $1,000.[i]

• While 46% of Americans surveyed have put off purchasing Life Insurance coverage, in part, because they are intimidated by the process, 48% of consumers say they are more likely to buy life insuring using simplified underwriting.[i]

• Because life insurance is significantly less expensive for the young and healthy, almost 4 out of 10 insured consumers wish they had purchased their policies at a younger age.[i]

Consider your needs and goals

Purchasing life insurance is an important decision which should be based on your specific financial planning needs and goals.

YOU MAY WANT TO CONSIDER…

- immediate and extended family
- children who may be enrolling in higher education
- grandchildren that have yet to be born
- declining health of loved ones
- family-owned businesses

Because life insurance works as a financial instrument as well as coverage for your loved ones, you may want to go over worst-case scenarios and potential conflicts that could potentially arise, prioritizing who may be most vulnerable in your passing with your spouse. A professional (i.e. life insurance agent, estate planner) can guide you through their experience with other clients.

Life insurance provides tax-free cash to your family in the event of your death, enabling you to plan for your loved ones' future in your absence. The money your beneficiaries receive can be an important financial resource to cover daily living expenses, pay the mortgage, cover funeral expenses, pay off a vehicle and other debts. Life insurance proceeds can help fund school tuition and remove the burden of debt that their children may encounter. A well-chosen life insurance policy can reduce the present-day stress caused by worry and financial concern, providing peace of mind that your life's purpose continues after your passing.

Many people see their needs change as they get older. Initially a life policy might have been needed for mortgage protection, but later in retirement, it might be used to replace an income stream if a partner were to die. Those on fixed or limited income may find solace knowing that a surviving spouse will not be faced with a financial burden after their death. The flexibility of life insurance makes it an attractive choice for those that want a wide variety of financial options as they age.

An agent can help you more accurately determine how much coverage you need. Evaluating income sources and financial responsibilities allows the agent to monetize potential obligations should a premature death occur. Family needs, school expenses, medical care, and retirement savings are all taken into consideration.

Your need for life insurance will change with your age and responsibilities. The amount of insurance you buy should depend on the standard of living you wish to assure for your dependents. Consider the amount of assets and sources of continuing income available to your dependents when you pass away. You should choose an amount of life insurance necessary to meet the needs you are trying to satisfy.

A balance needs to be achieved in this process. To be over-insured can negatively affect your day-to-day budget and threaten your long-range financial goals just as much as being under-insured can.

The different types of Life Insurance

Life insurance is categorized as either term or permanent.

Term life insurance, also called temporary life insurance, provides protection for a specified period of time. The most typical timespan of these policies are options of 10, 20, or 30 years—with some variations among different insurers. Term is the most affordable coverage because it provides only a death benefit. The policy price, or premium, typically stays the same throughout the term. The downside to term insurance is that once it expires, the cost of a new policy increases as you age.

Some term policies provide benefits in addition to the death benefit. For example, some polices offer a return of premium that will return all premiums paid at the end of the term if no death benefit was paid. The insurance company in this case will only earn the use of the premiums in this case and not the premiums themselves.

Permanent life insurance provides a death benefit for your entire life and also functions as an investment. A portion of each premium that a policyholder pays goes into an account known as the policy's cash value. This cash value will grow on a tax-deferred basis until you decide to take a withdrawal or borrow from the policy.

Permanent insurance is significantly more expensive than a term life insurance policy. Various fees and commissions charged can reduce your annual return on the investment part of the policy.

THE 4 MOST COMMON TYPES OF PERMANENT LIFE INSURANCE

- whole life
- universal life
- universal indexed life
- variable life

Whole Life, also known as ordinary life, offers premiums, cash value and death benefit guaranteed for your whole life. Whole life premiums are guaranteed fixed over the life of the policy. Policies offer a fixed death benefit and cash value that grows at a fixed rate of return, fully guaranteed. Variations exist: in some policies, premiums may be required to be paid for a set number of years before qualifying for these benefits while with other policies, premiums are paid throughout the policyholder's lifetime.

Universal Life generally provides the greatest flexibility in designing a policy based on specific goals. Universal life provides the ability in setting premium payments as well as death benefits. Each year, your policy is assessed "cost of insurance" (COI) fees, which are based on your age and the historical experience of the insurance company. The more likely that death claims could be paid out could mean a higher cost of insurance (COI). The opposite is also true, where favorable mortality experience could mean lower policy expense.

Most Universal life contracts offer minimal guarantees and because of the flexibility, management of the policy over the years is essential.

Indexed Universal Life insurance plans are an evolution of traditional universal life insurance. Indexed universal plans provide a death benefit and a separate cash value that may increase over time depending on how the funds in the policy are invested. Traditional universal life deposits the premium after insurance costs in the general account of the insurance company.

Indexed universal life allows funds to be invested in an outside source, such as the S&P 500 Stock Index. The funds are technically invested in futures, not the actual fund and returns will only be a portion of the actual returns. Because of this, downside market risks are avoided with indexed universal life insurance policies.

Variable Life allows you to choose among a variety of investments offering different risks and rewards. Instead of your premiums being deposited in the general account of the insurance company, you can choose which investment might make sense for you. Options can include stocks, bonds, or investments that guarantee principal and interest. Death benefits and accumulated value in the policy can vary depending on the performance of the invested assets AND the actual cost of the insurance benefit.

Variable life does carry risks along with financial rewards. These can include expenses such as investment fees, insurance fees and general operating costs—all of which are charged back to the policy and subtracted prior to calculation of net returns. Many different options are offered in this category; therefore, it is important to fully understand the details of the policy with in-depth research and the help of a professional agent/advisor.

Term vs. permanent Life Insurance

Both term and permanent types of life insurance provide protection. Permanent life insurance is intended for long-term benefits while term life insurance is intended for temporary usage.

Type of Policy	Premium	Face Amount	Cash Value	Policy Loans
Term	Low, but increases with age	Renewable into old age	None	No
Whole	Level	Level – can't be changed	Yes – can not choose investments	Yes
Universal	Flexible	Level – can vary	Yes – can not choose investments	Yes
Variable	Level	Level – can't be changed	Yes – can choose investments	Yes
Variable Universal	Flexible	Level – can vary	Yes – can choose investments	Yes

Permanent insurance is designed to insure you during a lifetime or as long as you make regular premium payments. Term is designed to provide protection for a specific time period.

Term policies are generally purchased for a specific need, such as providing tax-free funds to pay a mortgage if the insured dies. Permanent life insurance, on the other hand, can build up cash value over time. This cash value grows tax-deferred and can be used by either borrowing from the policy or converting it to supplemental retirement income. If your need for life insurance diminishes, permanent life insurance may have cash value available to you if you surrender the policy.

Cash value insurance is a longer-term policy, carrying more risk and responsibility. It is designed to be owned for a substantial period of time.

A decision to cancel or surrender early can be an expensive mistake, and you may lose out on this benefit if you fall on hard financial times or neglect to pay the premiums. Considering that premiums for permanent cash value life insurance can be much higher than a policy which only provides a death benefit, it's important to select a policy designed for your specific needs and goals.

$ THE ADVANTAGES OF CASH VALUE INSURANCE

- lifetime protection
- a fixed premium cost
- flexibility of premiums for universal and variable life
- retirement income: the IRS allows for the accumulated cash value to be transferred to an annuity (IRS 1035 exchange) without tax liability

Purchasing a Life Insurance Policy

According to the Limra 2021 survey, 42% of American households would face financial hardship within 6 months if they lost one income, while a quarter would find it difficult to meet their expenses within one month.[i] Selecting a policy that meets your goals and priorities will be easier if you have carefully considered your circumstances and estimated the likely financial obligations your beneficiaries will confront after you are gone.

How much coverage is sufficient? A 2023 Insurist study shows average life insurance coverage for American adults is $168,000 and younger generations are buying more life insurance than older generations.[ii]

The following numbers may be helpful when calculating the coverage needs:	
Family income to be replaced	A classic rule of thumb is that you should have 10 times the portion of your annual income which could not easily be replaced by your spouse. All circumstances are different, for example, young dependents may need a much longer time to help cover their daily living costs compared to families with independent adult children.[iii]
Burial costs, funeral expenses	In 2021, the median cost of an American funeral ranged from $6,970 with viewing and cremation to $9,420 with viewing and vault burial. [iv]
Children's education costs	Private schools, special skills training, and college costs can add up to a significant expense. According to the College Board, tuition and fees, plus room and board for an in-state student attending a four-year public college in 2022-2023 averages $23,250. Out-of-state students at public colleges, pay $40,550 on average, and students attending private colleges spend $53,430.[v]
Inflation	While the historically US annual inflation rate has been targeted to remain below 2% per year, October 2022 annual CPI at 7.7% is substantially higher.[vi]
Debts	Outstanding balance for mortgage, vehicles, credit cards, student loans, and medical bills.
Other dependents	Adult dependent children and parents who need care or financial assistance.
Additional factors	Charitable contributions and the current value of your estate should also be factored into the overall total coverage estimate.

Permanent coverage (such as Whole Life, Variable Life, Universal Life, or Universal Indexed Life) may bring more value to a person who has good cash flow. Though it will be more expensive than a term policy, a permanent policy can help you build a cushion for your retirement. Its value will grow tax-deferred over time as you pay premiums. In the event that you wish to use the cash value, you may (depending on the policy) be able to borrow from the policy, surrender it for its cash value, or use the IRS 1035 Exchange process for a tax-free conversion to an annuity that will pay you ongoing retirement income.

Temporary or Term policies last a certain period of time and must be renewed or replaced at the end of their term in order to continue coverage. They offer effective protection if you are unable to afford a permanent policy and have a temporary need. For example, you may have a greater need for insurance but a smaller budget for it when your children are young.

The best policy for you will depend upon your current circumstances and your financial goals.

Disclaimer

The information in this material is not intended as investment, tax, or legal advice. Please consult financial, legal, or tax professionals for specific information regarding your individual situation. The opinions expressed and material provided are for general information.

Citations

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