Life Insurance

Overview: Life insurance can play an important role in an investment plan. Choosing among the various types of policies available can be difficult. The following explains the different types of life insurance policies available and what to consider in choosing a policy.

Life insurance products are varied with many options that can be confusing. Trying to sort through the various forms of life insurance for proper coverage can be trying. It is important to understand some basic principles involving the uses of life insurance and the types of life insurance available.

Life Insurance Needs

The first thing to know about life insurance is that it is capital which is used to complete investment plans upon death. Deciding the proper amounts of coverage and the gaps the plan will face upon death should be done with help from a trusted advisor and input from family members who are affected by the plan. The following principles will help guide that discussion.

Define the Objective

Each person has an idea of what financial success means personally. Either it has been achieved or it has not. Examining the current financial picture and contrasting it with what the final financial picture should look like will give definition to any capital shortfall. From there, the life insurance needs can be assessed.

Define the Time Frame

How long will it take to accumulate the assets needed to complete the life insurance picture? Three to five years? Five to 15 years? Longer? The answers to these questions will help determine the appropriate life insurance vehicles needed to fill in the investment plan gaps.

Life Insurance Vehicles

Once objective and time frame have some definition, the next step is to design a coverage plan to meet specific objectives. As already mentioned, insurance is varied and flexible, so specifying objectives and goals allows investors and their advisors to look at appropriate products. The following are the general types of life insurance and the needs they address.

Term Life Insurance

Term life insurance is a contract that provides capital for a specific time period. The premium is roughly equal to the mortality and business cost of providing the capital to a specific member of a much larger group. Types of term are one-year, five-year, 10-year, 15-year and 20-year term, which allows investors to fill in gaps if the time frame of those gaps is known. For instance, if their investment plans will likely be complete in seven years, they may purchase insurance to cover the time period prior to the plan being completed (perhaps a five-year or 10-year policy). Once they have hit their number, they can drop the coverage. This is the most common form of insurance.

However, if the need for coverage is longer or permanent, then buying term is typically cost prohibitive. For example, the cost of coverage at age 100 is about $995 for every $1,000 in coverage. There are two basic products to secure long-term coverage: whole life and universal life.

Whole Life Insurance
With whole life insurance, the mortality and business expenses are averaged over the person's life expectancy. This pricing structure means the cost of the coverage is greater in the early years than the cost of term life insurance. Conversely, the cost of the term insurance would be far greater in the later years if both term and whole life were maintained over the same period.

Premiums in excess of the actual cost result in cash value (and dividends, in certain contracts.) These build up over time and can be used for various purposes throughout the life of the contract. However, these contracts are not for short term needs. Someone who takes out this type of contract needs to think of it as being in place for at least 12–15 years. By that time, the policy owner can get most (if not all) of the premium back if the investment or estate plan changes.

Universal Life Insurance
Universal life insurance is also known as flexible premium adjustable life insurance, which is an appropriate name for this type of contract. This contract combines a fixed annuity with an annual negotiable premium term life insurance contract. As the contract suggests, the premium is flexible within high and low annual targets. The premium covers the mortality and business expenses of the contract with a remainder going into a fixed income annuity. In later years, when the annual insurance cost is greater than the premium paid, the difference is pulled from the annuity.

A significant benefit of universal life insurance is that the premium can be less expensive early in the life of the contract, when money may be tight and the need for insurance is permanent. However, this can also be a significant risk, as it is possible to underfund the contract for future years. As the policy holder ages and the cost gets higher, the policy can lapse (or terminate) if there are not enough reserves within the annuity portion and the premiums become too expensive to maintain.

Universal life can be designed to have a guaranteed period of coverage. This works by having the premium specified by how long the coverage is to last. For example, if the coverage is to last a person's entire life, the insurance company makes various interest and mortality expense assumptions and specifies a specific premium for a specific time. If the premiums are paid on time, the death benefit will not terminate or lapse.

The benefit of this type of policy is that the premium is typically less (much less, in some cases) than a comparable amount of whole life coverage. The negative of this type of coverage is that the premium is no longer flexible and removing any cash value from the policy typically forfeits the guaranteed death benefit.

Flexible premium variable life is another form of universal life and operates the same way, but puts excess premiums into variable annuities with equity and fixed income investment options. The benefits and warnings are the similar.

Summary

Life insurance can be an important part of building a comprehensive plan. With many different forms of insurance available, it is important to understand the purpose behind purchasing policies to ensure getting the proper coverage. Seeking help from a trusted advisor can help ensure getting the proper coverage and adapting coverage over time as appropriate.

Tel: 805.418.7686 • Fax: 866.279.7711 • ted@fischerinvestmentstrategies.com
870 Hampshire Road, Suite U • Westlake Village, CA 91361
www.fischerinvestmentstrategies.com