Episode 142 Life Insurance

Patti Brennan: Hi everybody, this is Patti Brennan. Welcome to the "Patti Brennan Show." Whether you have $20 or 20 million, this show is for those of you who want to protect, grow, and use your assets to live your very best lives.

Today's podcast is part of the AskPattiBrennan series, short and practical. The topic today is life insurance. You know, it's kind of a boring subject. I asked my team, "Do people really want to learn about life insurance?" I got a resounding yes.

Bernadette said we get questions on our website about life insurance. First, let's define what life insurance is all about. It's basically to create money where it doesn't exist yet. In other words, what caused a problem also solves it.

Insurance is there to help a family, to help a business, or maybe, if you're in this position, again, in that latter category of 20 million or above, to help offset the cost of estate taxes. You can have group insurance, or you can have private insurance. Group insurance is fine.

It used to be that group insurance was cheaper than private coverage. That's no longer the case necessarily, so definitely shop the coverage. When you're thinking about the type of insurance or… Do you even need it? Why would you want to get, for example, private coverage? Usually comes down to three categories.

We often find young families need the coverage if one or both spouses are working, and the family is dependent on both of those incomes. Life insurance can serve as a tool. That's all it is guys. It is not an investment. It is a tool to create capital if someone was to predecease the other.

The worst thing that could happen, and unfortunately it has happened with three of our families, where a young family lost one of the parents. It's hard enough to lose a parent. It's even worse to lose two parents, because the survivor must go out and work two and three jobs to make ends meet. Don't let that happen. This is an easy problem to solve.

Family coverage, typically the first thing that people think about. If you're involved in a business, it is a great tool for businesses to cover key people. For example, if there is a loss of someone where there would be a gap in services, that would be a good use of key term insurance.

Another example would be if you're involved in a business. You could be a partner, or a business owner and you have key people that work there. You may want to get some insurance if they're in a car accident on their way home from work. That would be a significant loss.

The money could be used as a stopgap to keep the business moving forward even despite that loss. Partners often get insurance on each other because, geez, the worst thing that could happen, frankly, and I've seen it, is that there isn't any insurance, someone passes away and the surviving partner ends up in business with the spouse. Probably not an ideal outcome.

Family coverage, business coverage. What about that last thing, which is estate planning? It was a very popular tool when the exemption to avoid estate taxes was $600,000 or even a

million. Now that the exemption is approaching $12 million per person, and we have this thing called the Portability Clause, using insurance inside of an irrevocable insurance trust is less necessary.

However, if you have it, what's the worst that could happen? You've got insurance. If there is no tax, it is not a big deal. The insurance company still must pay the death benefit. It ends up going to the family as a bonus if you will.

Most of us don't necessarily want to enrich our kids that way, but again, it's a heads you win, tails, you break even. It's probably one of the most tax-efficient tools we have available in the estate planning area.

First, we need to define, is there even a need? Second would be, if there is a need, how much is enough versus how much is too much? The one thing that you don't want to be doing, and I would not want you to be doing, is spending a lot of money for coverage that is overkill because your resources are important.

You want to make use of every dollar. This is one of those types of insurance you don't want to collect on, so make sure that someone's running the numbers to determine, if there is a need, how much? That's number one. Secondly would be, is it a temporary need or is it permanent?

Young families often find that it's just temporary, maybe 10 or 20 years. I usually encourage families to go for a 30-year level term. I'm going to get into the different types of insurance in a minute, just to give you that extra guarantee.

What about permanent? What would be a permanent need? Again, going back to that business, the two partners, for example, my husband owns a business. He was in business with his brothers. They had insurance on each other. By the grace of God, they got it six months before Joe was diagnosed with a terminal illness.

That death benefit gave Brennans the ability to continue their business despite the loss of their rainmaker. Made all the difference in the world. That would have been more of a permanent need.

Full disclosure, we got term insurance in that case. When Joe was diagnosed, we looked hard at maybe converting that into permanent coverage if he lived beyond the term.

Since I'm talking about that, let me talk about the different types of coverage. Again, temporary needs, term insurance. Permanent needs, permanent insurance. Term insurance comes in many different flavors. You can get an annual renewable term. That tends to be the least expensive where the insurance premiums increase every year as you get older.

There is also convertible term. That's the kind that Joe, and Ed, and his brothers had. At any point up until the age of 70, they could convert the term insurance into permanent so that, beyond the age of 70, they still had coverage. Convertible terms are an important feature I would want everybody listening to look for.

Reentry term. What is that? Reentry just basically means that if you go beyond the 10 or 20 years and the premium is going to skyrocket, increase by 10 times, can you take a new physical and prove that you're still in good health and lower that premium? If so, that's called reentry. You can reenter at a lower premium.

Last, but not least is level term. Level term is what I was referring to earlier. It has a guaranteed premium for the period, say for the first 10 years, guaranteed not to increase the first 20 years or 30 years. I'm a fan of not having a lot of risk when it comes to this type of coverage.

I like the guaranteed term. Just make sure that it has some of the other features that I referenced. There are other types of, again, flavors. They are much rarer. There's decreasing term, or increasing term, or interim. Not very popular. I wouldn't pay a lot of attention to that. That's term for temporary needs.

What is this thing called "permanent?" Before we started the podcast today, I was talking with my team, Doug, Carrie, Bernadette, and one of them came up with this idea of overfunding insurance. If that's being proposed to you, that would be more of a permanent coverage.

In permanent insurance, what that means is you're building cash value over time. It comes in two types, universal life or whole life.

Whole life is that coverage that many of us, when we graduated from college, we were getting phone calls from our friends who were recruited by insurance agencies to buy whole life insurance to lock in the coverage or lock in the cost when we are young.

That's whole life. That can be appropriate and great for long-term permanent needs. Basically, it's more expensive than term insurance. You're building cash value over time. There are certain things that you can do with permanent insurance, but first and foremost, make sure that there is a need because, again, it's expensive.

Universal life is also referred to as flexible premium adjustable life. That sounds attractive, doesn't it? Basically, universal life is a combination of term and permanent, meaning, the cost for the underlying insurance increases as you get older. That's not built-in or guaranteed.

However, the rising cost is offset by the cash value that hopefully is growing over time. You can adjust your premiums to suit your cash flow needs at the time, but the death benefit tends to remain constant. You've got whole life and universal life.

There are hybrids with universal life. You can get variable universal life, which is basically life insurance that has sub-accounts that are investment vehicles, similar to mutual funds, where the cash value might grow faster than what a standard universal life policy might credit you. That tends to be based on current interest rates.

Whether you choose to take the risk of building cash value over time with variable, or you want to go with a more stable growth rate over time, it’s totally up to you, totally up to what your cash flow is looking like and what you might need. Ultimately, that's the most important thing.

I mentioned that one of the most efficient things that you can do with an insurance policy is to put it into an insurance trust. That's a great way of avoiding a lot of tax. If you do that, the death benefit comes in triple tax-free. Life insurance is not subject to income taxes.

If it's owned by a trust, there is no federal estate tax and no inheritance tax. As it relates to a permanent need, whether you go with whole life or universal life, it is first and foremost always important to determine, do you even need the coverage? If so, for how long?

Again, those examples might be for a family that would like to have the coverage far beyond when the kids graduate from college or in a business that wants to be a sustainable business no matter how old the owner or owners might be.

The estate planning area tends to be a more permanent need because eventually, we all die. The interesting thing about that is estate taxes used to be a permanent problem. Fast forward, they have turned out not to be as that exemption has increased to $12 million each.

Many people who had insurance trusts found they were no longer exposed to taxes, they are retired, didn't want to pay these high premiums anymore, and allowed those policies to lapse. Again, permanent isn't always permanent.

What about this idea of overfunding a permanent policy? That tends to be a conversation that people who are advocating for it will bring forward. What that means, in English, is that you put in additional money over and above what is required by the insurance company.

Why would you ever want to do that? The idea would be you build up a lot of cash value that is earning tax-deferred interest or rate of return and you can pull it out tax-free if it's done right. While it looks good on paper, I would be careful about that because, wow, can that blow up.

For example, if there are loans that are taken against the policy and the policy ends up lapsing, well guess what? You’ve got to pay all the taxes on the growth of that account all at once. That is a nasty surprise because usually the money has been spent, so be very careful about overfunding an insurance policy.

Also, be careful about the modified endowment contract rules because you can't always get the money out tax-free. Permanent insurance has many uses. Just understand what's most important to you. Insurance can serve many purposes. Some people use it to fund an incentive trust, for example, where they get a policy, and it is used to fund college education for grandchildren.

Other people might use it to donate to charity. That's a cool way of supporting the causes that you believe in. Ultimately, it comes down to what's important to you. What do you think about? Who do you worry about? What's the best way to cover your life?

Hopefully, that answers some of your questions. If you have any more questions, please go to our website at keyfinancialinc.com. I'm happy to brainstorm with you. Hey, it's a free consultation. By the way, it's not a pitch. I'm just here to answer your questions and help you to live that better life. Thanks for joining me today. Take care.