PERMANENT LIFE INSURANCE EXPERIENCES A REBIRTH

By David Appel and David Shannon

Many times, we are asked by prospects and other advisors, “Why do people have permanent life insurance policies?” That answer can vary, depending on the individual’s circumstances, the nature of the planning and the goals of all parties involved. There are many ways to use the powerful features of permanent life insurance, in the traditional planning sense, as well as some planning opportunities that were sometimes overlooked.

One of the cleanest and simplest uses of permanent life insurance often is associated with estate planning. Typically, this strategy involves an irrevocable life insurance trust owning and serving as the primary beneficiary of the life insurance policy. There are many funding strategies that individuals and families can use to complete this planning. All of these strategies are executed in the hope of reducing the tax burden to the next generation upon the death of the parents or grandparents. The answer to the “why” question in this strategy is twofold: 1) ownership of the policy by the irrevocable trust removes the death benefit proceeds from the estate of the individual or family, 2) the proceeds from the policy, when paid out, can be used to pay any pending tax burdens upon the last insured’s death, and the death benefit paid to the beneficiaries is protected from creditors and lawsuits when the policy is owned by one of these trusts. (In Malaysia, the family trust can be created under Schedule 10 Para 5 (1) of the Financial Services Act 2013)

The trust-owned life insurance strategy described previously is one that most advisors are familiar with executing, and they are discussing this with their clients almost every day. It would appear that the next step up from the “why permanent life insurance” question is more focused on the individuals and families who are not exposed to potential taxes upon the death of a family patriarch.

Over the past five to 10 years, the need for permanent life insurance has extended well beyond the “high net worth” client. Today, people are using permanent life insurance for the powerful use of its cash values and the freedom it provides in retirement, along with its ability to leave a legacy to family or charity. In these scenarios, life insurance is looked at more as an asset, rather than just for the death benefit.

The features of the permanent life insurance product portfolio have evolved over the years, which is positioning with a multitude of choices when it comes to products that build cash value. As always, the tax-deferred growth and potential tax-free distributions of the cash value still remain, along with the values of the policy being protected from both creditors and lawsuits. Cash value life insurance increasingly is being looked at as an intelligent savings vehicle for some individuals. The cash values can be used in times of emergency, for college funding and as a potential stream of income in retirement.

For example, the evolution of whole life products and the ability to structure the premiums in more defined ways, in terms of potential guaranteed premium amounts and lengths of time, have opened up many opportunities in our business. We have many clients who are working in the financial space. More of them are finding whole life products as an alternative to other investments in the portfolio. On top of the permanent insurance death benefit, using one of the limited-pay whole life products can provide a policy holder with guaranteed cash values. That cash value has tremendous value, and could be used to help supplement the individual’s retirement income. In doing so, the life insurance policy has created an asset class of its own within this individual portfolio.

With the reduction in corporate pension plans and other deferred compensation programs, many clients are faced with an overwhelming amount of uncertainty surrounding their retirement income. When a client is preparing for retirement, and factoring their ongoing income streams without the security of a pension or deferred compensation program, they have to make a number of assumptions. For example, if an individual retires at age 65 with $1 million of investible assets and he is calculating his retirement income on a net 5 percent rate of return, $50,000 may not provide the purchasing power that is required for his family going forward. In this planning scenario, a permanent life insurance policy of $500,000, for example, would empower this client not only to live off of the 5 percent interest on this $1 million account, but to provide the ability to tap into that principal as well. The leverage that the permanent life insurance provides this individual is the security that, regardless of when he passes away, the portfolio that is providing this income stream will be infused with $500,000 of tax-free money upon death. These life insurance proceeds provide the client with the peace of mind to live off more than just interest in retirement because they have the security of knowing the life insurance will be paid to their spouse upon death. In the event that their spouse pre-deceases them, they could then transfer the death benefit proceeds to their children, grandchildren or a charity of their choice.

In the event that an individual is fortunate enough to have a pension as a part of their retirement income planning, permanent life insurance is a leverage tool for the individual involved. Where the leverage comes into play in this scenario is relative to the pension option that the individual chooses upon retirement. The retiree who has a pension and a spouse has to decide whether to take a maximum monthly benefit for life with no benefit to the surviving spouse, or to take a lesser monthly benefit amount with a survivor option to the spouse. If the spouse passes away prior to the retiree receiving the pension, the pension is not recalculated to offset this death.

Again, this is another opportunity to use the leverage of permanent life insurance. Using the pension maximization concept, the client in this scenario can use the additional monthly income to purchase a permanent life insurance policy for the spouse. For example, if a 60-year-old man is retiring, selects the maximum option and receives an additional $1,000 of income each month, he could take half of the additional benefit ($500 per month) and purchase $500,000 of permanent life insurance for his wife. Now the permanent life insurance is serving as a future income -producing asset for the wife. There is also a benefit to this planning strategy for couples who have longevity in their respective families, because the longer this couple lives, the more valuable the permanent life insurance becomes.

Permanent life insurance has been a staple for individuals and families throughout the course of time, and will continue to be used as a valuable planning tool well into the future. There are many opportunities for insurance professionals to position life insurance as an asset, one that all clients and advisors should be looking to as an option within their portfolio.

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