PERMANENT

INSURANCE OPTIONS

There is only one absolute, when it comes to using life insurance in estate planning. The coverage must be permanent. To address estate planning needs requires coverage that cannot be outlived. The real questions come when trying to determine which type permanent policy to use; and there are several, although some are more appropriate than others. Most have both permanent death benefit and cash values, while others have guaranteed death benefit that others do not. Still others are designed to be used as an investment alternative, while others are specifically designed to provide permanent death benefit. The following are short synopses of the general attributes of each type of policy.

WHOLE LIFE

Whole life (WL) insurance, specifically participating WL, is the first type of policy most people think about when talking about permanent life insurance. It will work well for estate planning, because the face amount of coverage is guaranteed for life. It also has cash value that is guaranteed to equal the face amount of the policy at maturity, usually at age 100. In addition, WL policies pay annual dividends that can either buy additional paid-up insurance, accumulate at interest or be used to help pay future premiums. The guaranteed cash value can only be accessed in two ways. First by surrendering the policy or secondly by borrowing the money from the policy. Long term borrowing of the guaranteed cash value is ill advised as it can lead to a policy lapsing creating adverse tax consequences. When the dividend option chosen is to buy paid-up additions, which is usually the case, the PUA cash value can also be accessed by loans. However, they can also be accessed by surrendering PUAs, without putting the base policy at risk. It's drawback for estate planning is that it's much more expensive with less flexibility than other options. The reason it's so much more expensive is that the insured is paying for permanent death benefit, cash values and dividends, with the same dollar. Usually, for estate planning purposes the only goal is permanent death benefit that can't be out lived, and cash values are usually irrelevant. This is especially true when the insurance is inside an irrevocable trust.

UNIVERSAL LIFE

Universal life (UL) was created to be a more flexible and less expensive alternative to whole life. Its flexibility is in the insureds ability to change the face amount and adjust premiums. UL also has cash values that are more easily accessed than are WL cash values. They can be borrowed, but at a much lower interest rate than WL. However, they can also be withdrawn from the policy. They cash value can also be overfunded to take advantage of the unique tax advantages life insurance offers as a savings alternative. However, when used for estate planning needs, the cash value is only relevant to the extent they are adequate to maintain the coverage.

This is the main problem with UL as an estate planning tool. Since the permanency of the death benefit is based on the cash value being enough to pay future mortality charges, low interest rates can have and have had an adverse effect on cash value growth, thus putting existing UL policies at risk of lapsing. This has been especially true for UL policies written before 2009, when interest rates dropped dramatically and have stayed down. Policies that were projected to stay in force to age 100 are now at risk of lapsing many years sooner. There has also been a problem with insurance companies increasing the mortality charges, over what was originally projected; and this has forced many policies to require significantly higher premiums to keep the policies in force **(Clients who have UL policies over ten year old should request in-force illustrations from their carriers, so they can head off any problems)**. Low Interest rates, non-guaranteed mortality charges and the short guaranteed death benefit duration makes UL less than ideal for estate planning purposes.

INDEXED UNIVERSAL LIFE

Indexed universal life (IUL) is like universal life in that it has flexibility and has cash values. However, it differs in two very significant ways. First, the death benefit can be guaranteed for life and secondly is how the cash value interest is determined. The lifetime guaranteed death benefit makes IUL very suitable for estate planning needs. The cash value interest is based on what the S&P 500 index does each year. The cash value earns 100% of the index gain up to 9% (currently) but none of the gain above 9%. If the S&P loses value, the cash values do not. The flexible premium allows the insured to take greater advantage of the indexing of the cash values, if they so choose. However, the key for estate planning is death benefit that cannot be outlived by the insured. There is one contractual concern regarding the IUL death benefit guarantee. If any cash value is ever withdrawn from the policy the death benefit guarantee ceases and the death benefit becomes dependent on the cash values to stay in force, as is the case with universal life. Consequently, to be used for estate planning purposes, this point must be emphasized.

VARIABLE UNIVERSAL LIFE

Variable universal life (VUL) is permanent coverage but is ill suited for estate planning. It's cash values are invested in mutual funds and as such, the cash value can lose money. Since the death benefit is dependent on the cash values being adequate to pay future mortality charges, and the cash value being subject to market risks, means the death benefit isn't guaranteed and can be severely impacted by downturns in the market. These policies are also very complicated and since they are inappropriate for estate planning, which is the purpose of this reference guide, I won't go into the nuts and bolts of how it works.

GUARANTEED UNIVERSAL LIFE

Guaranteed universal life (GUL) was created to provide guaranteed permanent death benefit that can't be outlived, at the lowest cost possible. This makes GUL very suitable for estate planning needs. It's essentially lifetime term, in that the insured picks the age to which he/she wants coverage guaranteed and the premium required is guaranteed never to increase. It has virtually no cash value but is not dependent on the cash value to keep the policy in force. It's also flexible in that the premium and face amount can be changed. A GUL can be overfunded in the short run in order to have a paid-up policy that won't require premiums in retirement. For the same premium, a GUL policy will, on average, provide twice as much death benefit than will a whole life policy (see Appendix A). Someone in their 50s, 60s or even 70s needing life insurance to address an estate planning concern, has little interest in having cash values to spend one day. They would much rather focus their premium on what is needed, guaranteed permanent death benefit.

OVERVIEW

In my view, guaranteed universal life and indexed universal life are much more suitable than whole life, universal life or variable universal life for estate planning needs. When it comes to estate planning, the main and probably the only goal for life insurance is to guarantee the coverage for life. Only WL, IUL and GUL accomplish that. I don't recommend whole life because of its significantly higher premiums and lack of flexibility. As for GUL and IUL, determining which is most suitable should be decided on a case by case basis.