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Life Insurance: More than Pure Protection

Most of us have insurance of some sort. Car insurance, home insurance, liability insurance, life insurance, etc. Insurance is typically viewed as a necessary nuisance. We pay our premium to have protection in case we experience a loss. The focus of this article is going to be the benefits of life insurance aside from the pure protection, death benefit. Life insurance can help accumulate tax deferred growth by providing a flexible savings option with or without market volatility and can help offset the cost of long term care if needed.

For a life insurance policy to provide tax deferred growth the policy must have a cash value component. Most permanent life insurances provide a cash value, though there are universal life insurance policies that do not accumulate a cash value and provide permanent insurance. Due to the vast variety of insurance products that can provide a cash value it is beyond the scope of this article to review each one. Instead, I will focus on the benefits and encourage you to work with your financial professional to determine if this strategy fits your financial plan and which product would best fit your needs.

The cash value of a life insurance policy is a powerful tool in financial planning. In the preliminary years of a life insurance contract the premium payments are used to fund the cost of insurance. This increased cost causes the cash value to lag in the first 5-10 years of a life insurance contract.

There are several factors that will determine the breakeven point for premium payments and cash value. First, your health. The better an individual's health is rated the cheaper the insurance and the quicker the cash value can build. The amount of the premium will affect the cash value. The larger the premium the larger the credit to cash value. The final factor is how the cash value is invested.

In traditional whole life the cash value is invested in a conservative yield investment. This investment does not fluctuate with the stock market. The conservative yield investment is a stable fund that will not lose value. Current yields in this type of fund can range from 1% to 5% or higher depending on the previously discussed factors and the insurance company.

It is possible to invest the cash value in marketable securities (stocks, mutual funds, etc.). Insurance contracts that allow you to invest in the market are variable insurance contracts. This allows the owner of the insurance contract to invest the cash value which can cause the cash value to increase or decrease based on the performance of the underlying funds. The downside would be if the investments underperform or worse lose value it could undermine the life insurance and cause increased premiums.

I rarely recommend variable contracts. Here is my rational. In today's economy the average client has most of their wealth tied up in marketable securities (stocks, bonds, mutual funds, exchange traded funds, etc.). These investments are held in IRAs, 401(k)s, 403(b)s and other tax deferred accounts that are invested in marketable securities. This strategy would allow the average person to access the cash value of their life insurance when markets are down. Below is a chart reviewing some of the features of popular retirement plans and cash value benefits of life insurance:

Features	Life Insurance	Taxable Investments	401(k)/ Traditional IRA	Roth IRA	Municipal Bonds
Tax-deferred growth	√		√	√	
Tax-advantaged distributions	√			√	√
No contribution limits	√	√			√
No additional tax for early withdrawals	√	√			√
Will not increase tax expenses, Social Security taxation, or Medicare premiums	√			√	
Income tax-free death benefit	√				

One of my favorite features with traditional life insurance is the addition of a chronic care or long-term care rider. This rider allows for additional benefits to be paid out if the insured is deemed to need long term care. The benefit amount and how an insured qualifies for the benefit varies per carrier. It is imperative to understand how to qualify and what the benefits are before completing a contract.

Indemnity policies will cost more. An indemnity policy allows the insured to be paid once they have been diagnosed as chronically ill regardless if they have experienced additional costs or not. This can be very advantageous if cash flow is a concern. It also allows the insured to employ a family member, friend, or loved to help with their care if skilled nursing is not a necessity.

If the rider is not an indemnity policy, then it is a reimbursement policy. This policy requires the insured to spend their money then submit requests for reimbursement. It is more restrictive in how care is received and what care is provided.

Life insurance can provide significantly more protection than its pure protection, death benefit. I touched on a few of the key features in this article. Below is a chart that reviews some risks and how life insurance can help protect against them. The key is understanding what benefits and features are important to you. How your life insurance is designed will ultimately decide how it will benefit you and your family.

Risks	**Life Insurance Benefits**
Tax Risk	Income Tax Free Death Benefit
Withdrawal Rate Risk	Some Policies Offer Downside Protection
Sequence of Returns Risk (Timing)	Use Distributions in Years Following A Loss
Public Policy Risk	Alternative Funding Source if Reduced Social Security Income
Liquidity Risk	Future Accumulated Cash Value Accessible
Health Expense Risk	Chronic Illness Riders
Longevity Risk	Guaranteed Income Riders

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