Insurance Issues You Need to Understand:

HOW MUCH LIFE INSURANCE—AND HOW SHOULD YOU STRUCTURE IT?

By Matt Luckey, *Wealthwave*

According to an old saying, "Nobody ever *bought* life insurance—if they have a policy, it was *sold to them*."

In other words, you embark on a career, start making money, get married, and the life insurance industry finds you, through contacts and networking and sheer persistence. You probably resist at first, but if you've got even a moderate sense of responsibility, a policy with your name on it will soon be drawn up.

Along the way, one question will dominate: How much life insurance is enough? Obviously, everyone's situation is different, but certain guidelines tend to endure. The following is designed to provide some general guidance to help assist with that question and the other key issues that go into your decision-making around life insurance.

The DIME Method

One of the best-known methods for estimating life insurance needs also serves as a good introduction to the overall planning process. It's called the DIME method and it prompts you to consider your Debt, Income, Mortgage, and Education expenses. While Debt and Mortgage are simple (add up car loans, credit-card balances, mortgages, etc.), the Income and Education pieces are more nuanced.

Most policy buyers find that their income is the most important thing to insure. For someone with small children, the general rule of thumb is to have at least 10 times your annual income insured for the "I" portion of DIME. The thought process is that your surviving family could use 10 percent of the death benefit annually for 10 years—enough time to either get the kids launched into their own lives or for the surviving spouse to implement a plan B.

Another school of thought would have you insure your life at the rate of one times income for every year until your youngest child turns 18 (provided you also have the education piece handled). With respect to the Education part of the DIME method, it's very important to work with your advisor to project college expenses and your projected savings (in dedicate education-savings vehicles) so that you don't over-insure the Education element.

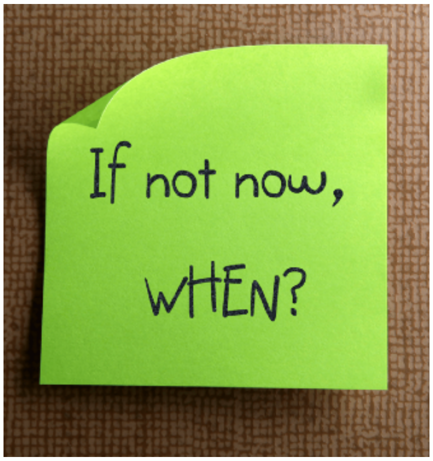
Term vs. Perm

Once you've established the appropriate amount of coverage, the next step is to decide on the type of policy that will best serve you. The most fundamental decision is whether to purchase term coverage or permanent coverage. Life insurance salespeople tend to be strongly drawn to one of two philosophies: Pay the extra cost of permanent insurance or "buy term insurance and invest the difference," i.e., invest the money that's left over because you selected a term policy, not a permanent (or "whole life") policy. In reality, that's an oversimplification, because neither approach works for everyone. In fact, many WealthWave clients own each type of product. The key is realizing the benefits and downsides of each approach and properly applying them to your unique situation.

Term insurance is just that: it provides coverage for a certain term, or length of time (typically 10, 15, 20, or 30 years). Term policies come with relatively low out-of-pocket costs because the premiums that you pay get you a death benefit and nothing more. If you don't die during the term, you don't get anything back for your money. In fact, over 98 percent of term policies never pay a death benefit. That's because when you can afford the premiums, you aren't likely to die and when you're likely to die, the premiums are so high you can't afford them, so you let the policy lapse. Even if you don't let the policy lapse, it will most likely cancel itself, since term policies only last until a certain number of years.

Permanent insurance policies require more money out of pocket. Instead of expiring at a certain time, they're designed to remain in force for your entire life so that, if designed and funded properly, your family is guaranteed to receive more in death benefit than you paid in premiums. Permanent policies also offer substantial living benefits such as long-term care protection (see our June 2018 article) and the opportunity to grow your money tax-free without the risk of loss. That said, their death benefits will generally be lower than the death benefit on a term policy.

While most insurance sales people push one approach to the detriment of the other, WealthWave advisors take the time to craft solutions for each individual need. As noted, many of our clients own both policies. That's based on their having an increased need for insurance in the early years, when their kids are young and they owe a lot on their house. But down the road, when the kids are out of school and the mortgage balance is lower, they no longer need as much insurance coverage. But they still need to plan for long-term care and retirement income. So we'll often structure a relatively larger term policy to cover the higher coverage need for the shorter period and a relatively smaller policy for permeant and long-term care coverage and retirement income.



Some term life insurance policies are described as "convertible." A conversion provision allows the owner of the term life policy to convert from the term life insurance policy to a permanent life insurance policy during a specified period of time without having to show that the insured is in good health. The conversion period is shorter than the duration of the term insurance coverage.

Group Term for Employees

According to Proponent Group survey data, 52 percent of members are employees of a facility and thus may have access to life insurance through their employer. Such insurance is generally provided under group term policies, which differ from permanent policies and individual term policies in a number of ways. The biggest advantage of group term is also its biggest disadvantage: you can obtain coverage without having to medically qualify. This can be a great advantage for members who have preexisting medical conditions that may disqualify them from obtaining insurance on their own.

Insurance companies can do this because group policies combine all employees into one pool of risk and spread the cost of covering less healthy employees by charging healthier employees more than they'd otherwise pay based on their health. If you are in one of these group-term pools and you judge yourself to be generally healthier than other employees of their course or club, you may unknowingly be subsidizing the insurance costs of your less healthy coworkers. Because the premiums for group term policies come out of each paycheck, these higher premiums often go unnoticed but can add up to hundreds of dollars more than your might pay under an individual policy. Thankfully, it's easy to obtain quick quotes to determine whether you're overpaying for group term coverage.

Considerations for Business Owners

In addition to all the personal considerations outlined above, the 32 percent of Proponent Group members who are independent contractors or business owners have additional, unique life insurance considerations.

For instance, if you have business partners, life insurance can be an effective way to address succession planning. A classic example would be an academy or practice that is owned by two or more partners. Should one partner die unexpectedly, family members of this deceased partner will deserve to be bought out or otherwise compensated for those years of hard work contributed to the business. Since such practices rarely have large sums of available capital handy to buy out the surviving family members, the business can purchase a life insurance policy and enact a buy/sell agreement to provide the liquidity needed to take care of the deceased partner's family without having to raise capital or dissolve the business.

In the above scenario, the family of the deceased partner is not the only party that stands to suffer a loss. The business itself would suffer after the death of a partner. A "key-man" life insurance policy would compensate the business for lost revenue. For instance, if a practice was largely built on the reputation of one of the partners, it may take some time to rebrand the company to focus on the skills and attractiveness of the surviving partner or partners. A life insurance policy could bridge that revenue gap.

Key-man polices don't only apply to the business owners. If you have a team of instructors (or even key marketing or administrative personal), your business would be impacted by an unexpected death. Life insurance could pay for the search for a new employee or compensate the business for lost instructing revenue while looking for and establishing the clientele of a new instructor.

If you're the sole employee of the business, the living benefits of certain life insurance policies can be used to protect your family's income not only in the event of your death, but in the event of an injury or illness that prevents you from generating revenue from teaching and coaching.

While the DIME method is useful as a starting point for determining the proper amount of coverage, there is no replacement for professional advice. We strongly encourage you to seek out a professional to help analyze your situation to develop the right approach to insurance. As outlined above, modern insurance policies can address many more needs than just protecting against an early death. Used correctly, it can be one of the most useful clubs in your bag.

*For more information or to schedule a time to review your retirement game plan, contact **Matt Luckey** at 770-418-0300 x122 or visit wealthwave.com/mattluckey.* PG