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Voices What accountants and their clients should know about life insurance

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There's an old adage: "What you don't know can't hurt you." Nothing can be further from the truth when it comes to the subject of life insurance for accountants advising their clients.

A more appropriate adage might be "Caveat emptor," or "Let the buyer beware." A better slogan should be, "An educated consumer is our best customer." But life insurance companies like it just the way it is: An uninformed insured person is their most profitable customer.

The purpose of this article is to inform and acquaint accountants with four examples of times where what you don't know can hurt you as it pertains to your clients' as well as your own life insurance portfolio.

Selecting and managing individual term insurance

Term insurance gives the insured and their family the biggest bang for their buck when it comes to obtaining significant amounts of life insurance coverage for the least cost. This is especially so when they're young and even moderately healthy, but it becomes exceedingly expensive for the insured at later ages. As a result, term insurance is a very profitable area for life insurance companies as less than 2% of their policies are ever paid as death claims. This occurs for two reasons: Most term policies expire at ages 80 to 82, and a great majority of life insurance buyers live beyond those ages.

One of the significant benefits of a term life insurance policy is the guaranteed right to convert the term policy to a permanent policy that can last for the rest of the insured's life regardless of their health. Keep in mind there are two important questions to ask when initially purchasing coverage. The first is to find out when the term insurance conversion option expires. It can range from ages 65 to 75.

The second is to determine whether the conversion option in the insurance company being considered allows the insured to convert to any of the insurer's policies, or only to a specific policy. The limited choice is not in an insured's best interest, but a large number of insurance companies do just that.

It's important for the consumer to better understand how to use term insurance so it benefits them rather than the insurance company. In order to do that the client must look at their coverage as one long-term continuous flow of buying term insurance and investing the difference in a tax-deferred vehicle to allow the compounding accumulations to be used at a point in the future to pay for a more expensive and permanent guaranteed universal life insurance coverage that can last as long as they'd like.

It's also extremely smart for individuals to occasionally compare their cost to other available coverage to make certain they are getting the most value for the premiums they are currently paying. The cost of similar coverage for the same age insured from one company to another can vary as much as 40 to 50%. That's why it's important to deal with an independent experienced professional.

Wrong use for group association term life insurance

There are advertised offers from professional associations, such as accounting, legal and medical societies, to have members buy their association's group term insurance. Their products initially come with an extremely competitive low cost in the early years (ages 20 to 40) but with premiums gradually increasing every five years. They become less competitive at age 40 and then extremely overpriced in later years (50 to 75). Unless an insured person only wants coverage for a five- to 10-year period they would always be better off financially with a fixed 20- or 30-year guaranteed term duration rather than one that increases every five years.

An attorney recently referred a retiring partner aged 62 from an accounting firm in New York City to review the life insurance portion of his retirement package. The client had a choice to take a 100% benefit for himself and not leave a benefit to his spouse, or to take a 75% payout and leave a 50% payout for his spouse. The client was advised to take the 100% pension settlement and use the extra 25% payout to purchase a $1.6 million life insurance policy on his life, with his wife as the beneficiary. That 25% amounted to a $40,000 difference. After taxes he had approximately $25,000 net available annually to pay for a $14,000 premium for his $1.6 million dollar policy.

Everything looked like it was going to work out fine. However, when the life insurance policy was reviewed it was found that they used the state CPA society's five-year group term insurance policy because it had the lowest premium, but what they failed to realize was that at age 65 the $14,000 premium was going to increase to $21,000; at age 70 the premium would increase to $31,000; and at age 75 the premium would increase to $43,000 and then end at age 80. So, if the client lived beyond age 80, there would be no income for the spouse.

Not much of a retirement plan and not what he had in mind for his wife's future. The best we were able to do was advise him as to how much he would have to reduce the death benefit every five years to keep to his available $20,000 to $25,000 maximum premium to allow him to pay for his wife's retirement benefit.

That client at age 60 ideally should have purchased an affordable smaller amount of permanent life insurance coverage that would have remained in force for the rest of his life. If the client still insisted on purchasing a larger amount of temporary coverage, he would have been better off having purchased a 20-year guaranteed term policy, with a conversion option to age 75. Although the premium would have been higher for the first five years, it would on a cumulative basis have been less expensive than the policy that increased every five years.

Furthermore, the client should have systematically converted $200,000 of term insurance for $100,000 of permanent insurance starting at age 65 every other year for the next 10 years. Doing so would have provided the client's wife with an ongoing stream of income from her husband's death benefit and then at her death the principal, if it hadn't been depleted, could be left as an inheritance for their children.

Other examples of using the wrong type of life insurance policy that we've come across include using the term insurance that will expire at age 80 to fund a special needs trust. The intent of such a trust should be to make certain the policy survives the insured, and that the death benefit is available for the child regardless of how long the parent lives. This can be accomplished with a guaranteed universal life insurance policy whose coverage can remain in force until age 90, 95 or longer. The longer the duration the higher the cost.

Life insurance requires active management

Life insurance used to be quite simple: term or whole life. It was similar to walking into an ice cream store where you had two choices: chocolate and vanilla. Today it's like walking into a Baskin-Robbins with its 31 flavors. Some are used for a death benefit, while other strategies are best used for their tax-deferred "living benefits." More on that in a minute. The point is there are many different types of life insurance policies today with many more moving parts, new features and riders that enhance a life insurance policy.

For those individuals who want life insurance to last on a permanent basis beyond age 80, they require a permanent type of a policy. The most common type is called a universal life insurance policy. However, the vast majority of universal life insurance policies are not guaranteed. Non-guaranteed life insurance policies require active management to make certain their coverage doesn't expire before the insured.

A great many of these policies have already expired years earlier than anticipated as a result of the decreased interest rates over the last 20-plus years, as well as the neglect on the part of the amateur trustees. The amateur trustee is usually the eldest child of the insured, who wasn't aware and received no guidance advising they should have increased their premiums to make up for the reduced interest rates. The sooner one discovers how long their non-guaranteed policy will last at the current premium they're paying, the more options they'll have available and the less costly the solution will be.

Many owners or trustees of non-guaranteed universal life insurance mistakenly believe that life insurance is a "buy and hold" asset and doesn't require active management, when in fact life insurance is actually a "buy and manage" asset. Recent case law indicates that trustees need to be aware of their exposure to personal liability as there's been an increase in lawsuits filed against trustees for not fulfilling their fiduciary responsibilities, which

Not considering the 'living benefits' of a life insurance policy

While many clients are familiar with the death benefits of a life insurance policy, very few are familiar with the 'living benefits." For the purposes of this article, I'll focus on three important living benefits that everyone should be familiar with for their as well as their client's benefit.

- **Tax deferral strategies:** Life insurance can be utilized for its long-term tax deferred benefits to supplement one's retirement income. Any type of a long-term deposit — be it a conservative fixed annuity, or the more aggressive variable annuity with no limits as to losses, or the registered index linked annuity, which now provides preset limits to losses in exchange for a cap on gains — can be placed under the tax-deferred umbrella of life insurance. Systematic deposits accumulating on a tax-deferred compound interest basis is a very efficient way to supplement one's retirement.
- **Tax-free long-term care expenses:** Several years ago, as a result of the Pension Protection Act, it became permissible to withdraw funds from the death benefit of a life insurance policy to pay for long-term care expenses and do so on a tax-free basis. These alternative ways to pay for long-term care costs are known as "combo/linked" or "hybrid" plans. Before an individual purchases traditional long-term care insurance, a comparison of the two should be made as each strategy has several benefits and drawbacks.
- **Life settlement vs. cash value surrender:** There are several reasons an individual insured person may decide to either stop paying a life insurance premium or surrender the policy to the insurance company for its cash surrender value. However, before they do either, they should consider a "life settlement," an alternate exit-strategy of selling their life insurance policy just as they would sell a house or a car. Doing so can yield a significantly higher amount of money than merely surrendering the policy back to the insurance company.

In the past Congress has repeatedly tried and failed to curtail some of the tax-advantaged benefits afforded the life insurance industry. All the while, the insurance industry has consistently grown and expanded the features and benefits it offers to consumers, be they individuals, professional advisors or business owners. Use the guidance of an experienced independent CFP or CLU to learn about the living benefits of a life insurance policy and to assist you or your client through the selection, underwriting and maintenance process to make certain that the death benefit doesn't expire prematurely as so many already have.

Lastly, it's important that the insured compares what they think they have — the duration and death benefit — to what they actually have and that they're getting the most value and coverage for the premium they're currently paying.

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He has appeared as a guest on Wall Street Week, Fox Business News & News 12. He's provided CPE & CLE continuing education credits to NYSBA, ABA, AICPA, NYSSCPA, & the estate Planning Council. He co-authored an American Bar Association Flagship publication, Jan 2017, titled; "The Advisors' & Trustees' Guide to Managing Risk" The Jan 2019 issue of Commerce Clearing House, referred to him as; "One of today's best brains in life Insurance.