Planning for the Unexpected: Life Insurance

Here are some considerations for podiatrists.

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When planning for survivor income needs, it is necessary to consider the ongoing income needs of your survivors, as well as any immediate or short-term lump sum needs. When considering future income needs, the starting point is to determine how much income will be needed for the surviving family. Is the desire to maintain the current standard of living of the family, or will their needs be less? Will the family be staying in the same home or moving to a different location? Will the surviving spouse be earning income, or do you want to provide sufficient income so that the surviving spouse will not need to generate income? From the home mortgage standpoint, would you like to provide a lump sum payment for the balance of your home mortgage or other debt?

With regard to college education funding, you will also need to consider whether you prefer to leave a lump sum equal to the future college funding needs of your children or if you prefer to assume college costs would be covered from the cash flow available to the surviving family.

These decisions are difficult, but they are very important factors in quantifying life insurance needs. If you have sufficient investment assets to meet your survivor income objectives, there may not even be a need for life insurance. People buy life insurance when they do not have sufficient assets to provide for their survivors. If you have sufficient assets, then you are considered to be self-insured. That is why a physician's greatest need for life insurance often is early in his or her career, prior to having saved substantial investment assets. Many different types of life insurance products are available to meet the varying needs of physicians.

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Once you have defined the qualitative and quantitative need for life insurance, you can begin to determine which product in the life insurance marketplace best meets your objectives. First, decide whether your specific life insurance need is "temporary" or "permanent." Temporary implies that your needs are relatively short term. A good example would be if you are trying to provide survivor income in the event you die prior to becoming self-insured. Once you have accumulated sufficient assets to provide for your surviving family, you may no longer need the life insurance for that particular exposure. Permanent insurance, on the other hand, is generally purchased with the understanding that the policy proceeds will be paid out at the time of your death, regardless of when that occurs, even if you live beyond your expected mortality age.

Term Insurance

If your life insurance needs are temporary, then term insurance may be the most appropriate vehicle to use. Term insurance has no cash value or savings component attached to it. Quite simply, you pay your premium, and if you die during that policy year, the death benefit is then paid to your beneficiary. "Decreasing term" has a level premium, but a decreasing death

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benefit. It usually is used in conjunction with financial obligations that reduce over time, such as mortgages, or other types of amortized loans. Two types of term insurance that offer a level death benefit, but a differing premium paying structure, are available.

Annual renewable term has a yearly increasing premium, which increases with the higher mortality cost associated with being a year older and a year closer to your expected mortality age. It is used primarily for financial obligations that remain constant for a relatively short period of time. Level premium term, on the other hand, offers a level premium payment amount over a fixed number of years, typically 5, 10, 15, or 20 years. This is appropriate for needs that are finite in length, such as ensuring coverage until a young child has completed college, becoming self-insured through an increased net worth, or reaching retirement age with sufficient retirement income to meet your needs.

There are other differences among term policies. The major areas that affect premium rates are policy provisions dealing with renewability and convertibility. Renewable policies typically allow the policyholder the option of continuing term coverage after the stated period of time has expired. Although the renewal will be at a higher premium rate than during the defined time period, new medical underwriting is not required. If during the term period, you become ill in a manner that would deem you to be either uninsurable or insurable but with an added-on rating that would substantially increase premiums, you would at least have the option of continuing coverage with your current term carrier.

A convertible policy, on the other hand, provides the insured with the option to convert the term policy to a permanent policy at some time in the future. Once again, this may be accomplished without proof of insurability or medical underwriting. Some term carriers provide both renewable and convertible policy provisions with their contracts.

Other provisions, known as riders, can be added to certain policies for an additional cost. The "waiver of premium" rider allows the insured or policy owner to stop making premium payments if he or she becomes disabled and is unable to work and earn an income. The accidental death rider would obligate the insurance company to pay out to your beneficiary double or, in some cases, even triple the stated death benefit if the insured dies in an accident.

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A newer rider, which is starting to get a lot of attention, is the accelerated death benefit. You may be able to receive a portion of your own death benefit, while you are alive, in the event you have a major medical condition, such as metastatic cancer, chronic renal failure, or pancreatic cancer, that is expected to lead to death within a short period of time. This rider will make it possible to obtain needed funds immediately to help with medical bills or other support issues during a terminal illness.

Permanent Insurance

Permanent insurance needs are solved through varying types of whole life and universal life policies designed to stay in force throughout one's lifetime. Unlike term insurance, where premiums generally increase as the insured gets older, most permanent life insurance premiums remain level. These policies combine the death benefit protection of term insurance with a savings element known as "cash value." Life insurance cash values grow on a tax-deferred basis, thus creating a supplemental tax advantaged savings vehicle.

Unlike other tax-deferred vehicles such as IRAs, retirement plans, and annuities, life insurance cash values are not subject to the minimum penalty-free withdrawal age of 59½. In addition, and of particular interest to physicians, is the fact that in many states life insurance cash values and the death benefits (assuming there is a named beneficiary) are shielded from creditors, thus creating an effective asset protection strategy. The accumulated cash values form a reserve that enables the insurer to pay a policy's full death benefit while keeping premiums level.

Depending on the specific life insurance company, cash values of permanent life insurance policies may be withdrawn or borrowed over the life of the policy. Cash value loans or withdrawals can also be used to supplement retirement income or fund college education costs.

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The main attribute of whole life insurance is the inherent guarantee that, as long as premium payments are paid in a timely manner, the policy will remain in force regardless of any changes in the insured's health.

Universal Life Insurance

Universal life insurance policies differ from whole life policies by separating the various components of the policy, such as cash value, mortality costs (the actual cost of the insurance), and other expenses. This allows the insur-

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ance company to build a higher level of flexibility into the contract, which, in turn, provides the policyholder with the ability to make adjustments in response to changing needs and circumstances. This flexibility can include the amount and frequency of future premium payments, as well as the ability to reduce the amount of the death benefit as one's net worth increases.

Whether it is a traditional whole life or universal life insurance policy, it is important to understand the variables that affect the growth of your cash value over time. Most permanent insurance cash value increases are due to either the dividend-paying ability of the insurance company (based on the company's earnings and profitability) or the insurance company's own investment returns expressed as an interest rate percentage (interest rate–sensitive insurance).

In both cases, insurance companies offer a guaranteed minimum amount, or interest rate percentage, that they will credit to the policy. With interest rate–sensitive policies, which are the most common type used in universal life insurance, the insurance company invests its cash assets in relatively conservative investment vehicles such as government and high-grade corporate bonds, although it may also diversify into equities and real estate. The results of the investment strategy are passed through to the policyholders via cash value additions at a specific interest rate.

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Variable Life Insurance

Variable life insurance, whether it is a whole or universal life policy, actually allows policyholder to have more control over the growth of his or her cash value account. The policyholder can allocate a portion of each premium payment to one or more investment sub-accounts or separate investment options, based on their specific risk tolerance and long-term growth objective. Deductions for expenses and mortality charges are taken by the insurance company prior to allocation to the specific sub-accounts.

Most variable life policies offer the policyholder a wide range of investment options, including various stock and bond mutual funds. Depending on the specific insurance company, options may include index funds, real estate funds, foreign stock funds, small company, and other types of sector funds. Also included may be a fixed account option in which the insurer guarantees a fixed rate of return.

Cash Value Life Insurance Policies

With most cash value life insurance policies, there may be substantial surrender charges associated with canceling or terminating the policy. These charges usually are highest in the early years of a policy and usually decline over time, typically from 7 to 15 years, depending on the specific insurance company. If your needs have changed since you purchased the policy, you do have options other than simply surrendering the policy. Permanent insurance options also may include the ability to suspend premium payments, while at the same time maintaining some reduced level of coverage.

Based on the amount of cash value within the policy, life insurance illustrations can be prepared to determine the feasibility of actually lowering the face amount of the death benefit, thus lowering the mortality cost within the contract. This is accomplished by determining the amount of reduced benefit that can be supported by the current level of cash value. In this manner, you may still be able to take a partial withdrawal or loan against the policy, either now or in the future, but avoid full surrender, thus eliminating any insurance company–imposed surrender charges and any potential income tax liability.

Policy cash value loans allow the policyholder to borrow a portion of his or her cash value account.

If reducing the death benefit is not reasonable, another option may be to convert the permanent policy to a paid-up term insurance policy. An analysis is completed that will determine how long the term coverage will remain in force, based on the mortality cost of the coverage. If this strategy is implemented, the cash value is used to pay for the paid-up term coverage, thus eliminating any ability to access cash values in the future.

You can, however, access cash values without terminating a policy through either cash value withdrawals or loans. Policy cash value loans allow the policyholder to borrow a portion of his or her cash value account. The rate charged by the insurance company typically is lower than current market loan rates. The loan may not have to be repaid, but if there is an outstanding policy loan, the company will reduce the death benefit if the insured dies before the loan is repaid. **PM**

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