ACCESS Education Systems

DOLLARS & Sense

Family Financial Education Foundation

Edition 2, Volume 4

Why Buy Life Insurance?

Life insurance. Bah. Who needs it? Well, that's a good question—one that we each ask ourselves at some point along life's journey. In a nutshell, determining whether to buy life insurance or not depends on your own situation. If you don't have people that depend on you (such as a wife and kids) and the income you bring home, then you probably don't need life insurance. But if your salary is vital to supporting your loved ones, making the house payment, covering other bills and sending your kids to college, then life insurance can cover these financial commitments should you pass away.

In this issue of Dollars & Sense, we discuss how to determine if you need life insurance and how much coverage is appropriate. We also cover what types of life insurance policies are available and insurance terms and definitions to make understanding your policy a little easier.

How to Determine if You Need Life Insurance

Let's face it. The unexpected death of a family member is devastating for survivors. All too often, the hardships are compounded by financial losses that could have been avoided with adequate life insurance. Such coverage can protect your loved ones against the financial hardships of your death by giving them the means to manage certain expenses. This cash (known as the death benefit) replaces your income and can help your family meet many important financial needs like daily living expenses, mortgage payments, and college savings. What's more, there is no federal income tax on life insurance benefits.

To figure out if you need life insurance, you need to think through the worst-case scenario. If you died tomorrow, how would your loved ones get along financially? Would they have the money to pay for your funeral costs, medical bills, taxes, debts, lawyers fees, etc.? Would they be able to meet ongoing living expenses like the rent or mortgage, food, clothing, transportation costs, healthcare, etc? What about long-range financial goals? Without your contribution to the household, would your surviving spouse be able to save enough money to put the kids through college or retire comfortably? The Washington, D.C.-based Life and Health Insurance Foundation for Education has outlined the following scenarios to help you understand how life insurance might apply to your particular situation.

- **You're Married**—Most families depend on two incomes to make ends meet. If you died suddenly, could your family maintain its standard of living on your spouse's income alone?
- **You're a Single Parent**—As a single parent, you're the caregiver, breadwinner, cook, chauffeur, and more. Yet nearly 40% of single parents have no life insurance whatsoever, and many who do have coverage say they need more.

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What Types of Insurance Policies Are Available?

This article provides a snapshot of some of the most common types of life insurance policies: term life, whole life, fixed universal life, and variable universal life.

Term Life Insurance

Briefly, term life insurance is generally considered the simplest and least expensive form of life insurance coverage. It provides death benefit coverage at a guaranteed, consistent premium for a specific period of time—typically one to twenty years depending upon which term life product you choose. Since premiums for term life policies are low as compared to other types of life insurance, term life insurance is ideal for new families seeking affordable protection. While term life insurance doesn't include the ability to accumulate cash value, it can help you maintain its lifestyle, cover college tuition and pay off a mortgage in the event of your death. Term life insurance:

- Provides protection only during the term of the policy, then the coverage ends
- Offers a death benefit only; does not allow for cash value accumulation
- Has a low premium that is guaranteed for a selected period. At the end of the stated guaranteed period, premiums generally increase significantly to keep the policy in effect.

Whole Life Insurance

Like term life insurance, whole life insurance pays a fixed death benefit for a fixed premium amount. Generally, if the premium is paid on time, the policy will remain in force. But, unlike term life insurance which terminates at the end of the specific period, whole life insurance continues to cover the insured throughout his or her life. In addition, whole life insurance has a cash value feature that is guaranteed. You can access these cash values through policy loans for emergencies or other financial needs. Some whole life insurance policies may generate cash values greater than the guaranteed amount, depending on interest rates and how the market performs. Whole life insurance:

- Allows for cash value growth on a guaranteed basis
- You may elect to discontinue coverage and surrender the policy for the cash value, if any, or use existing cash value to purchase a policy with a lower death benefit amount that requires no additional premium payments.
- The policy may mature for its cash value at a specific time (e.g., age 95). Often the cash values are guaranteed to equal the policy death benefit at maturity.

Fixed Universal Life Insurance

If you're looking for a way to combine life insurance death benefit protection and cash value accumulation with flexible terms under one policy, you may want to consider a fixed universal life insurance policy. Within certain limits, fixed universal life insurance lets you adjust when and how much you pay in premiums. You also can adjust the amount of your insurance coverage in later years, although increases in coverage may require additional evaluation of your health and other factors at that time. You affect the accumulation of cash values through the amount and timing of your premium payments.

Some of the key benefits of this insurance option include the flexibility to let you reduce or skip payments (within certain constraints) when times are tight, and pay additional premiums to increase the tax-deferred cash values when your budget allows. Also, the more premium you pay, the greater the potential cash value. However, if insufficient premiums are paid, the policy may have little or no cash value and may lapse. Here's how fixed universal life differs from other life insurance policies:

- Flexibility—you can adjust premium payments as desired
- After a certain time period and within certain stated requirements, you can adjust the death benefit amount.
- Ability to make additional premium payments to enhance cash value
- Where cash value amounts are sufficient, you may elect to withdraw money from the cash value or borrow from it. Distributions and policy loans reduce the death benefit.

Variable Universal Life Insurance

Variable universal life insurance policies typically provide the flexibility of universal life insurance with the ability to invest in the stock and bond market through associated portfolios. As your family's financial situation changes over time, you may want to consider a variable universal life insurance policy if you want death benefit protection with the option to invest the policy's cash value. Such a policy allows growth potential through use of underlying portfolios. It also offers flexibility to adjust premiums and amount of coverage, depending on your financial situation and needs.

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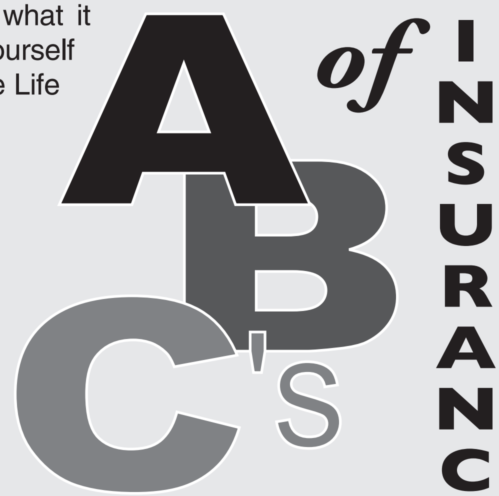
Variable universal life:

- Provides flexibility and the chance to build cash value
- Allows policyholder to choose from a variety of underlying portfolios

To quickly summarize, term life insurance helps provide a foundation of financial security upon which to build your financial plan. By contrast, whole and universal life insurance policies allow you to build cash value to help meet unexpected future financial needs and allows the policy to stay in force for a longer period of time. ■

To Understand Your Policy, Learn a New Vocabulary

Comprehending what your life insurance policy really says and what it promises to deliver can be made a lot simpler by familiarizing yourself with the following key insurance terms made available by LIFE, the Life and Health Insurance Foundation for Education, www.life-line.org.



15 Life Insurance Terms You Should Know

1. Accidental death benefit—Also known as double indemnity, a provision in a policy that doubles or triples the benefit in the case of death by accidental means.
2. Beneficiary—The person named in a policy as the recipient of the insurance money in the event of the insured's death.
3. Cash surrender value—The amount available in cash upon the policy owner's termination of a permanent life insurance policy before it matures or becomes payable by death.
4. Claim—The demand by an individual to recover losses covered under an insurance policy.
5. Contingent beneficiary—The person designated to receive life insurance policy proceeds if the primary beneficiary should die before the person whose life is insured.
6. Convertible term insurance—A type of policy that allows the policy owner to change a term insurance policy to a permanent policy without providing evidence of insurability. The premium rate for the permanent policy is normally based on the age of the insured at the time of the conversion.
7. Death benefit—The sum of money paid to a beneficiary when a person insured under a policy dies.
8. Dividend—A refund of excess premium paid to the owner of an individual participating life insurance policy.
9. Permanent life—Life insurance that is designed to provide lifelong protection with generally level premiums. There are three main types: whole, universal and variable. All permanent policies accumulate cash value.
10. Policy—The contract or agreement made between the insurer and the insured.
11. Premium—The payment to the insurance company for insurance coverage.
12. Term life—Life insurance that provides coverage for a specific period of time, usually from one to twenty years. Term policies provide a death benefit only if the insured person dies during the term.
13. Universal life—A permanent policy that gives the owner the right to vary premium payments and the death benefit within certain prescribed limits. The rate of return on the accumulation account fluctuates according to investment performance but will not fall below a guaranteed minimum rate of return, such as four percent.
14. Variable life—A permanent policy under which the cash value of the policy may fluctuate according to the investment option performance of a separate account fund. Most variable life policies guarantee that the death benefit will not fall below a specified minimum.
15. Whole life—A permanent policy designed to last for life and for which premiums stay level. ■

How Much Insurance Do I Need?

So, how much life insurance do you need? The answer isn't really how much life insurance you need, but rather how much money your family will need after you're gone. Ask yourself:

- How much money will my family need after my death to meet immediate expenses, like funeral expenses and debts?
- How much money will my family need to maintain their standard of living over the long run?

Life insurance proceeds can help pay immediate expenses including uncovered medical costs, funeral expenses, final estate settlement costs, taxes and other lump-sum obligations such as outstanding debts and mortgage balances. They can also help your family cover future financial obligations. But how do you know if you need $100,000; $500,000; $1 million or more?

The Life and Health Insurance Foundation for Education recommends conducting what's called a Capital Needs Analysis. First, you evaluate your family's needs. Gather all of your personal financial information and estimate what each of your family members would need to meet current and future financial obligations. Then add up all of the resources that your surviving family members could draw upon to support themselves. The difference between their needs and the resources in place to meet those needs is your need for additional life insurance.

Or, another approach is to use this handy tool for estimating your need for life insurance. Remember that this tool is only intended to be a guide. It doesn't consider every factor that might affect your life insurance needs. For a more accurate and detailed analysis, please consult a financial advisor.

First calculate your family's monthly expenses. Second, estimate your monthly after-tax income. Include your income, social security benefits, interest-bearing assets or retirement plan benefits.

Third, subtract your monthly expenses from your estimated monthly income. This amount will be your family's unmet income need.

Multiply this amount by 12 to determine your families unmet yearly income need.

Fourth, estimate the number of years your family might have this unmet need. For example, if your death occurred tomorrow, approximately how many years would the need exist? How many years until your children would be self-supporting?.

Multiply the number of years by your determined amount of yearly income need. This amount will be your family's total unmet income need.

Fifth, Estimate the amount of potential one-time expenses and outstanding debt from mortgages, college expenses, credit card debt, etc.

Sixth, estimate funeral expenses and estate settlement costs. While expenses vary, funeral costs typically range from $5,000 to $10,000. Other final expenses may add another $5,000 to $10,000 dollars.

Finally add the amounts for potential one-time expenses; final expenses and your total unmet income need to obtain a total estimate of your life insurance need. ■

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- **You're a Stay-At-Home Parent**—Just because you don't earn a salary doesn't mean you don't make a financial contribution to your family. Childcare, transportation, cleaning, cooking and other household activities are all important tasks, the replacement value of which is often severely underestimated. Some surveys have estimated the value of these services at over $40,000 per year. Could your spouse afford to pay someone for these services?
- **You're Single**—Many single people don't feel they need life insurance because no one depends on them financially. But there are significant reasons for carrying at least a small policy. For instance, being responsibe for paying for their own funeral and burial expenses is important to many people. Some single people provide financial support for aging parents or siblings. Others may be carrying significant debt that they wouldn't want to pass on to family members who survive them. If you're in these types of situations, you should consider owning life insurance because you wouldn't want your loved ones to be burdened financially in the event of your premature death.

Hopefully you now have a better understanding of whether or not you need life insurance. If the answer is yes, then the next step is to determine how much coverage makes sense. ■

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