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Life Insurance Delivers Unique Financial Value

When times get tough and money gets tight, people tend to buy only things they really need and make sure they get the best value possible. When they purchase a financial product, they want to be sure it will deliver exactly what it promises.

Since death is a certainty regardless of the economic climate, most people still understand the urgency of protecting their family's future financial health and ability to pass on assets. It's not something they can put off forever.

Many clients don't realize that when it comes to transferring wealth, all their assets aren't created equal. Some assets may be able to pass on greater value than others. It can be tempting for people to take the easy route and tell their families to take whatever assets remain at their death and divide them equally. Implementing such a simple plan, however, is seldom financially efficient and makes it likely that some hard-earned wealth will not be passed on because of unnecessary taxes, costs and fees.

Those who want to maximize the value of what they pass on need to examine all their assets with the goal of deciding which ones to keep, which ones to consume before death and which ones to reposition into new assets that will increase the value of their financial legacy. They should be on the lookout for features like these:

- ✔ **Predictable Value.** The asset's value on the date of death is known in advance and with relative certainty.
- ✔ **Value Not Directly Linked to Market Performance.** Asset value at death is relatively stable and is not directly influenced by the performance of any particular market.
- ✔ **Liquidity.** The asset is easily converted into cash at death and is not reduced by commissions, transfer costs or management fees.
- ✔ **Growth/Leverage.** The asset's date-of-death value will likely exceed the costs of acquiring and maintaining it.
- ✔ **Income Tax Free Growth.** Asset growth is income tax free when distributed at death.
- ✔ **No Probate.** The asset can be distributed immediately to those entitled to receive it without the costs and delays of probate.
- ✔ **Possible Estate Tax Avoidance.** The asset may be owned in a manner that avoids federal estate taxes.

Evaluating assets with these features in mind can be a good indicator of how much value they will deliver to family members after death. If an asset doesn't deliver many of these features, it may make sense to consume it during life or reposition it into another asset that is likely to be more reliable or efficient.

Aligning Requirements with Life Insurance

One asset with the desired features of flexibility and financial efficiency is life insurance. That's why many wealthy families use life insurance as part of their wealth

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transfer planning. Using the points above as our guide, let's explore what a policy that is in force at an insured family member's death potentially delivers:

✔ **Predictable Value.** The policy may be structured to pay a known death benefit amount when the insured dies.

✔ **Value Not Directly Linked to Market Performance.** The policy may be structured so that the death benefit may not directly depend on financial market performance.

✔ **Liquidity.** The death benefits are paid in cash; generally no income taxes, transfer costs, commissions or management fees are subtracted from the death benefit.

✔ **Growth/Leverage.** Premiums paid for death benefit protection can provide significant leverage in the early years and may provide a competitive rate of return through life expectancy.

✔ **Income Tax-Free Growth.** Policy death benefits (including amounts in excess of premiums paid) are generally income tax free under IRC Section 101.

✔ **No Probate.** Death benefits may be structured to be paid directly to the beneficiaries; through the beneficiary designation the policyowner directs how the proceeds should be distributed.

✔ **Possible Estate Tax Avoidance.** Ownership of the policy may be structured so that the death benefits will not be subject to federal estate taxes as part of an insured's taxable estate.

In addition to generally aligning with the client's wealth transfer needs, each of these features is valuable by itself. As such, the ability of life insurance to potentially deliver *all* of them makes it a uniquely valuable wealth transfer tool.

Of course, each situation is different and should be analyzed independently. The amount of wealth a life insurance policy is capable of producing at death will depend on a number of factors, including the insured's age, health, type of policy, amount of premiums paid and year of death. When life insurance is available at reasonable rates, the death benefits from a well-structured policy can be quite useful in stabilizing and preserving family wealth. Very few other assets have as many features so well suited to passing on a financial legacy.

Financial Efficiency—
Internal Rates of Return

For some people this list of potential advantages isn't enough. They want proof that life insurance will provide strong financial value for the premiums paid. They can choose from among many financial products and strategies in addition to life insurance. They often have experienced tax and legal advisors available to give them advice tailored to their situation. As such, they may ask for a numerical analysis of how financially efficient life insurance could be for them.

Over the years, internal rate of return analysis (IRR) has become an accepted way to measure financial efficiency. With life insurance, the IRR is the interest rate at which the premiums paid into a policy will have to grow in order to equal the death benefit expected to be paid out at the insured's death. Many software programs will make IRR calculations, and some life insurance companies include them in their product illustration systems.

A thorough IRR analysis will consider the fact that life insurance death benefits are generally paid out income tax free. Based on the insured's marginal income tax bracket, IRR software will compute the after-tax interest rate at which the policy premiums would have to grow in order to equal the projected policy death benefit.

Because it is impossible to know the year in which an insured will die, IRR software usually computes IRRs for a series of years. Unfortunately, using a range of IRRs can be confusing for clients. Although it is possible the insured could die anywhere within the range illustrated, advisors often suggest their clients focus their attention on the IRRs for the years nearest the client's life expectancy. These IRRs can give the client a relatively good idea of how that particular policy might perform financially and how efficient it might be in transferring their wealth. Clients must decide for themselves what constitutes an acceptable internal rate of return in years they deem most important.

Timeless Value

Today's financial decisions are all about value, particularly among clients who are considering a range of products to assist in passing on their wealth. When it comes to transferring wealth, life insurance has the potential to deliver value in many different ways. And because death benefits are paid in cash, they can be used to accomplish many objectives. Some clients could benefit from adding a life insurance component to their wealth transfer plans.

When advising clients, please be sure to demonstrate what a well-structured life insurance policy can do and customize an internal rate of return analysis for them. If they are insurable at reasonable rates, life insurance may be able to help increase the value of what they pass on to their children and grandchildren. That's an attractive proposition regardless of what the economy looks like these days.

This material is intended to provide accurate and reliable information on the subjects covered. It is general in nature and the strategies may not be suitable for everyone. It is not intended to provide specific tax, legal or other professional advice.