Practical Accountant

October 2005

Finding the Right Balance

There are many aspects to life insurance planning, but it really comes down to checking the basics and evaluating the needs of the insured. ***By Howard W. Wolosky***

In the discovery stage of a financial planning engagement, clients are usually asked the following questions: Do you have life insurance? How much do you have? What type is it? But those are only the preliminary questions that should be asked and even those questions have a number of facets that must be studied.

Evaluating Existing Policies

The marketplace has changed over the past 10 to 15 years according to Lonnie Davis, director of CBIZ Accounting, Tax & Advisory Services (Plymouth Meeting, Pa.). "Certainly the cost of term insurance has continued to come down over the years. So, it is a very inexpensive way to purchase substantial coverage. Permanent products, such as whole life, universal life, and variable life, have become more efficient. Internal fees, asset management charges, mortality and expense loads, and cost of insurance rates have all been reduced allowing products to be priced lower or to accumulate higher cash values," he explains.

John Napolitano, chairman and CEO of U. S. Wealth Management, Inc., a Braintree, Mass. firm specializing in providing financial services programs through CPA firm affiliates, begins a life insurance planning engagement with what he calls a "quantitative guesstimate of what is going to happen in the future." His idea is to evaluate the possible needs such as income replacement and evaluate those needs against the variables in an insurance policy such as the rate of return, inflation, and spending. Whether it is in an individual situation or if a business is involved, he follows a similar approach. With a business or a professional firm he focuses on the value of the firm or business.

Napolitano takes a "quantitative and qualitative" approach to evaluating life insurance coverage so if children are the planned successors in a family owned business, in addition to evaluating the coverage, he will look to whether the children could operate the business after the insured's death. A problem that Napolitano sometimes experiences in dealing with business owners is that they act as if they are immortal delaying getting the recommended, and needed coverage.

Alan Kahn, president of AJK Financial Group, an estate planning, retirement, insurance, and investment firm in Syosset, N.Y., points out that one aspect of reviewing the coverage, is examining whether the client still needs that existing coverage.

Both Napolitano and Kahn strongly recommend that a financial planner get an in-force illustration from the insurance company. It shows the current and guaranteed assumptions of the policy. Kahn indicates, in reality, the insured is only buying the guarantees and then he adds, "in reality, the insured is only buying the guarantee of company." He points out many insurance companies are now not just offering universal life insurance policies, but are also offering the guaranteed universal policies.

Kahn carefully checks the current cash value of a policy, the guaranteed cash benefit, as well as the guaranteed death benefit to see if they fit the insured's needs. He warns the insured can't be married to one company and advises to check out the net worth of the insurance company and how it is rated by the rating services. Napolitano utilizes a similar approach and Comdex is one of the rating systems he uses.

Checking beneficiary designation is also very important particularly Kahn explains with remarriage and divorce being so common and because life insurance proceeds almost always pass outside probate. He gives the example of a separated couple going through a nasty divorce where the husband was advised to remove the wife as the beneficiary. He neglected to do so and, while the divorce was pending, he died in an automobile accident and the wife received all the proceeds from the policy.

Napolitano and Kahn both utilize Section 1035 tax-free exchanges to change insurance policies to get better or different coverage for clients. Because Napolitano is weary of some of the universal life policies offered in the 1990s of sustaining themselves at the high assumed rates they are based upon, he will often convert them to a guaranteed universal policy.

In converting any policy, particular attention must be paid to mortality rates and insurability of the insured observes Napolitano. At the Web site (www.life-line.org.) for the nonprofit Life and Health Insurance Foundation for Education, it is advised that before replacing an in-force policy with another policy, caution must be exercised. The advice is before dropping any in-force policy, you must review whether the health status of the insured has changed; the premium rate, cash value, and death benefits of the two policies; and the effect of any new contestability period. It is also advised to make sure the insured will pass any required medical examination and finally, that the new policy is in force before the cancellation of the old one.

Davis feels many clients don't realize the role insurance plays with regard to liquidity. "People of reasonable wealth believe they don't need insurance because they have money in their retirement plans or they have high valued real estate or securities portfolios. If these assets have to be liquidated there may be unanticipated tax implications or liquidation."

The key question about additional coverage, according to Lee Slavutin, principal with Stern Slavutin-2 Inc., an insurance and estate planning firm, in New York City, is, "Are the breadwinners in a family grossly underinsured for their 'human life value'?"

Davis observes that many people buy insurance more than one time during their lives. "So, we stress that it takes more than money to buy insurance. It takes good health. We often suggest peo-

A Life Insurance Needs Calculator

The Web site (www.life-line.org.) for the nonprofit Life and Health Insurance Foundation for Education (LIFE) can be very useful in convincing a reluctant client that life insurance planing on an initial and regular basis is important. For example, LIFE describes exactly how real people benefited from insurance in the form of essays and videos.

There are also detailed descriptions of how life events can impact life insurance needs. They run the gamut: having a child, getting married, buying a home, taking on debt, changing jobs, supporting aging parents, changes in a business, changes in marital status, college expenses, and retirement. What is probably most useful is the life insurance needs calculator at www.life-line.org./life_how_ineeds.html as it illustrates how those major life events might impact life insurance needs.

ple purchase a little more than they "think they will need because their situations will change and guaranteeing their future insurability becomes important."

The Unexpected Death of the Breadwinner

Actress and author Marilu Henner, in her capacity as spokesperson for the second annual Life Insurance Awareness Month campaign (last month) that was coordinated by the nonprofit Life and Health Insurance Foundation for Education, tells first hand how important life insurance can be.

She lost her father to a heart attack at 52 years of age when she was 17 years old. He was the sole breadwinner in the family and when he died his wife and six children survived. He died with considerable debts. The life insurance proceeds covered the final expenses, paid off the debts, and helped keep the Henner family in their home.

Special Situation and Policies

When there are second marriages, Kahn sees insurance as an equalizer when the insured wants to benefit the current wife and children from a prior marriage or when one child is in the family business and the other is not. He also finds second-to-die policies useful when there are disabled and special needs children.

Napolitano advises insurance particularly for sole practitioners such as a lawyer or a doctor. He sees it as a way for the surviving spouse to get the proper value for the practice without relying on the success of its sale.

A second-to-die policy is the standard estate planning tool for a married couple according to Slavutin. But he adds, "You need to look at the timing issue—how old will the children be when the second parent dies? Should the older parent be insured individually?"

Kahn explains that you have to customize the policy to the insured. For example he had a young client who made about $1 million per year, but he was spending virtually all of it. A high cash value policy was purchased as a means of enforced savings.

The Beginning and the End

Although there are intriguing aspects of life insurance planning Slavutin concludes always go back to the basics—adequate coverage, suitable product, and strong carriers. PA