Chapter 15
Life Insurance and Estate Planning

Chapter Objectives
- To calculate your life insurance protection needs
- To understand the important provisions in a life insurance policy
- To describe the major kinds of life insurance
- To be able to choose the type and amount of protection that is best for you
- To be able to plan for the orderly transition of a death estate

Life Expectancy

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Male</th>
<th>Total Female</th>
<th>White Male</th>
<th>White Female</th>
<th>Black Male</th>
<th>Black Female</th>
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<tr>
<td>0</td>
<td>76.7</td>
<td>73.9</td>
<td>77.3</td>
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<td>71.4</td>
<td>74.3</td>
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<td>15</td>
<td>62.5</td>
<td>60.1</td>
<td>63.1</td>
<td>60.3</td>
<td>58.2</td>
<td>61.3</td>
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<tr>
<td>20</td>
<td>48.3</td>
<td>45.0</td>
<td>49.7</td>
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<tr>
<td>65</td>
<td>17.0</td>
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<td>19.1</td>
<td>17.0</td>
<td>16.1</td>
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<tr>
<td>75</td>
<td>13.2</td>
<td>12.0</td>
<td>14.2</td>
<td>13.0</td>
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Who needs life insurance?
You need life insurance if you have financial dependents.

How to estimate your life insurance needs?
- Finding out funding needs
  - Transition Fund - immediate death-related needs
  - Family Maintenance Fund - ongoing support of survivors
  - Specialized Funds - special reserves
- Listing out funding sources
- Figuring out insurance protection gap
  - The difference between funding needs and funding sources

What is the transition fund? – Funding or expenses that will be incurred at the time of death

1. FUNERAL AND BURIAL EXPENSES $6,000
2. ESTATE TAXES 0
3. PROBATE COSTS 0
4. UNINSURED MEDICAL EXPENSES 1,300
5. OUTSTANDING LOANS DUE 15,000
TOTAL TRANSITION FUND $29,300

<table>
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<tr>
<th>Year</th>
<th>Total Male</th>
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<td>13.1</td>
</tr>
</tbody>
</table>
**What is the family maintenance fund?** – Funding for the ongoing support of dependent family

<table>
<thead>
<tr>
<th>MONTHLY SURVIVORS' EXPENSES</th>
<th>$4,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>MONTHLY SURVIVORS' TAKE-HOME PAY</td>
<td>$670</td>
</tr>
<tr>
<td>MONTHLY SURVIVORS' BENEFITS</td>
<td>$1,980</td>
</tr>
<tr>
<td>TOTAL CONTRIBUTION BY SURVIVORS</td>
<td>$2,950</td>
</tr>
<tr>
<td>MONTHLY MAINTENANCE REQUIREMENT</td>
<td>$1,350</td>
</tr>
<tr>
<td>ANNUAL MAINTENANCE REQUIREMENT</td>
<td>$16,200</td>
</tr>
<tr>
<td>Multiply by Annuity Factor</td>
<td>9.1622</td>
</tr>
<tr>
<td>Term of Fund (years)</td>
<td>10</td>
</tr>
<tr>
<td>Annual real return</td>
<td>2%</td>
</tr>
<tr>
<td>Annuity Factor</td>
<td>9.1622</td>
</tr>
<tr>
<td>FAMILY MAINTENANCE FUND</td>
<td>$148,428</td>
</tr>
</tbody>
</table>

**What are the specialized funds?** – For emergency, education of children, and retirement of spouse

1. **EMERGENCY FUND** $12,000
   - COST PER CHILD $44,000
   - NUMBER OF CHILDREN 3
   - ANNUAL REQUIREMENT $5,000
   - RETIREMENT YEARS 20
   - TOTAL SPECIALIZED FUNDS $244,000

2. **EDUCATIONAL FUND** $132,000
   - NUMBER OF CHILDREN 3
   - TOTAL SPECIALIZED FUNDS $244,000

3. **RETIRED FUND** $100,000
   - TOTAL SPECIALIZED FUNDS $244,000

4. **OTHER FUNDS** $0
   - TOTAL SPECIALIZED FUNDS $244,000

**What are the total funding needs?**

<table>
<thead>
<tr>
<th>FUNDING NEEDS</th>
<th>$29,300</th>
</tr>
</thead>
<tbody>
<tr>
<td>TRANSITION FUND</td>
<td>$29,300</td>
</tr>
<tr>
<td>MAINTENANCE FUND</td>
<td>$148,428</td>
</tr>
<tr>
<td>SPECIALIZED FUNDS</td>
<td>$244,000</td>
</tr>
<tr>
<td>TOTAL NEEDS</td>
<td>$421,728</td>
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</tbody>
</table>

**What are the total funding sources?**

<table>
<thead>
<tr>
<th>FUNDING SOURCES</th>
<th>$56,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>FINANCIAL INVESTMENTS</td>
<td>$56,000</td>
</tr>
<tr>
<td>TANGIBLE GOODS</td>
<td>$10,000</td>
</tr>
<tr>
<td>LIFE INSURANCE GROUP</td>
<td>$50,000</td>
</tr>
<tr>
<td>INDIVIDUAL</td>
<td>0</td>
</tr>
<tr>
<td>SOCIAL SECURITY</td>
<td>255</td>
</tr>
<tr>
<td>TOTAL SOURCES</td>
<td>(116,255)</td>
</tr>
</tbody>
</table>

**What is the insurance protection gap?** – This is the amount of life insurance you need to buy

| TOTAL NEEDS | $421,728 |
| FUNDING SOURCES | (116,255) |
| UNFUNDED NEEDS | $305,473 |
| UNFUNDED ESTATE LIQUIDITY | 0 |
| ***THE LIFE INSURANCE PROTECTION GAP*** | $305,473 |

**Some useful Website for calculating life insurance needs**

The special language of life insurance policy - The basic policy

- **Face Amount**
  - dollar amount of life insurance protection stated on the face of the policy

- **Premium**
  - periodic payment on policy

What are participating vs. nonparticipating insurance?

- **Nonparticipating insurance**
  - typically stock insurance companies
  - premiums not dependent upon the future earnings and mortality experience of the company

- **Participating insurance**
  - typically mutual insurance companies
  - may return part of the premium as a dividend if company has favorable earning

What are cash value and surrender value?

- **Cash value**
  - equal to the savings accumulated during the existence of the policy
  - insured can typically borrow against cash value

- **Surrender value**
  - amount returned to the policy holder at termination
  - cash value plus surrender dividends less outstanding loans and surrender charges

What is “lives covered”?

- **Single life policy**
  - taken out on the life of one person

- **Joint life policy**
  - covers more than one person, pays out at the death of the first
  - Survivorship joint life
  - pays out at the death of the last individual

- **Family policy**
  - coverage for several family members in one policy

Who is the “beneficiary”? 

- **Beneficiary**
  - person or entity that receives proceeds

- **Co-beneficiaries**
  - persons or entities that receive proceeds

- **Contingent beneficiary**
  - also called secondary beneficiary
  - receives proceeds if primary beneficiary dies before you do

What are “riders”? 

- Specialized provision meant to modify or extend coverage. Examples (Textbook page 390):
  - accelerated death benefits
  - accidental death benefits
  - disability waiver premium
  - nonforfeiture
  - incontestability clause
  - guaranteed insurability
  - convertibility
  - renewability
  - cost of living adjustment
  - settlement options
  - grace period
What are the different types of life insurance policies?

- **Term Insurance**
  - no cash value buildup; provides only death protection

- **Cash Value Insurance**
  - provides both death protection and cash value buildup
  - functions as both death protection and a savings vehicle

What are the types of term insurance?

- **Increasing-Premium Term**
  - Level death benefit with increasing premiums in order to offset age-related risks
  - Renewable term may be extended over some predefined period without proof of insurability

- **Level-Premium Term**
  - Hold premium constant over a set number of years such as 5, 10, 15, or 20.
  - May be renewed at a higher premium

- **Decreasing Term**
  - Premium remains constant
  - Increased risk of mortality offset by declining death protection

- **Group Mortgage Life**
  - A type of decreasing term insurance meant to pay off the balance on a mortgage

What are the types of cash value insurance policies?

- **Whole life**
- **Limited payment life**
- **Modified whole life**
- **Adjustable life**
- **Universal life**
- **Variable life**
- **Variable-universal life**

What is whole life (straight or ordinary life)?

- Premiums: level over time
- Face value = cash value + death protection
- Over time, cash value increases, death protection decreases, but face value stays the same.

What is limited payment life?

- Premiums: level up to certain age, usually 65, then cease
- Higher premiums in early years than straight life before premiums cease
- Interest earned on cash value offsets premiums in later years

What is modified whole life?

- Premiums: level, lower than whole life
- Automatically reduces the death benefit as the insured ages as an attempt to meet the needs of the family throughout the life cycle
**What is adjustable life?**
- Both premium payments and face amount are adjustable within limits
- Typically contains a guaranteed insurability rider for increasing face amount

**What is universal life?**
- Flexible premium payments that affect the size of the cash value build up
- Premium is a contribution that is voluntary within certain limits
- Contribution is split between charge for term insurance and an interest earning account
- Periodic reports on term protection, management expenses, and interest earned on cash value

**What is variable life?**
- Similar to universal life but with fixed annual premiums
- The insurer chooses an investment portfolio offered by the insurance company thus there is speculative risk

**What is variable-universal life?**
- Combines the flexible premiums of universal life with the investment selection of variable life.

**What are the tax advantage of cash value insurance?**
- Interest earned on cash value avoids immediate taxation
- Taxes must be paid when interest is paid out or policy is surrendered
- Pay out may be avoided by a policy loan
- Beneficiaries receive a tax-free payout at death of insured

**How to select the right type of policy?**
- Term insurance provides the greatest face amount of death protection at the lowest premium
- Compare cash value insurance with other investments
- Consider a term plus savings plan
- Review the tax advantage of cash value insurance (see next slide)
- Comparison shop
How to do comparison shopping?

- Wide range of prices can make comparison shopping worthwhile
- Review the cost indexes (smaller numbers are better)
  - Interest-adjusted net cost index (surrender cost index)
  - Net payment cost index
- For an example, visit [http://www.whole-life-insurance.com/Actual-Results-Comparison.html](http://www.whole-life-insurance.com/Actual-Results-Comparison.html)
- Be wary of using the indexes to compare dissimilar policies
- Indexes may depend upon faulty promises

How to check out the insurance company? – Important as you want the company to be there when you need it

- Rating agencies
  - Standard & Poor’s: [http://www2.standardandpoors.com/NASApp/cs/ContentServer?pagename=sp/Page/HomePg](http://www2.standardandpoors.com/NASApp/cs/ContentServer?pagename=sp/Page/HomePg)

Estate Planning – Some Terminologies

- Death estate
  - Property and wealth transferred at death
- Will
  - A legal declaration of how your property is to be disposed of at death

What happens if you die with or without a will?

- If you have a valid will, you die testate
  - The person who leaves a will is a testator(trix)
  - The person named in the will who manages the death estate is the executor(trix)
- If you die without a will, you die intestate
  - If you die intestate, the state decides how your property will be divided at death
  - The state appoints an administrator(trix) to manage the death estate

What are the two ways to divide estate?

- Per capita division
  - The inheritance is divided equally among all surviving family members.
- Per stirpes division
  - The inheritance is divided equally among branches of the family
  - An example: A family has two children (A and B). One of them (A) died, leaving two grandchildren (Aa and Ab). The other (B) does not have children. The grandparent’s estate will be distributed as follows
    - Per capita: the three surviving members (Aa, Ab, and B) each receives 1/3
    - Per stirpes: B receives ½, Aa receives ¼, and Ab receives ¼.

How to change or revoke a will?

- Codicil
  - An amendment to an existing will, modifying or explaining specific terms
- Revoking a Will
  - Writing a new will
  - Change in family status
**What is the letter of last instructions?**

Provides advice on the management of your death estate and the distribution of your assets.

- Inventories your assets - life insurance, pension survivor benefits, and you financial holdings
- Names individuals who are familiar with your financial estate - stockbroker, accountant, lawyer

**What is probate?**

- Court process in which assets are transferred according to the will
- Seven major steps of probate:
  1. Validation of will and appointment of executor/trix or administrator/trix
  2. Informing heirs and claimants of death
  3. Inventory and valuation of property and debts
  4. Payments of claims against the estate
  5. Determination and payment of taxes due
  6. Determination of division and heirs
  7. Division and distribution of estate

**What are trusts?**

A legal arrangement in which property is held by one party for the benefit of another.

- **Trustee**
  - One who controls the property in the trust
- **Grantor**
  - One who establishes and funds the trust

**Some technical terms with respect to trusts**

- **Fiduciary responsibility**
  - Legal responsibility to manage the trust in the best interests of the beneficiary
- **Testamentary trust**
  - Takes effect at death
- **Living trust**
  - Takes effect during the grantor’s lifetime

**What are revocable vs. irrevocable trust?**

- **Revocable trust**
  - Can be changed by the grantor
- **Irrevocable trust**
  - Cannot be changed by the grantor once it is established

**What are the possible contractual relationships?**

- **Joint tenancy**
  - Each owner has an undivided interest
  - Property passes to co-owner at death
- **Tenancy in common**
  - Each owner has an undivided interest
  - Property can be individually transferred
- **Community property**
  - Property acquired in marriage by the joint efforts of both spouses
Checklist for Estate Planning

Documents

✓ A valid will
✓ Letter of last instructions
✓ Durable power of attorney
✓ Living will
✓ Health care durable power of attorney