THE Wealth REPORT

Today's life insurance policies can offer much more value than simply a death benefit. While helping secure the financial future for loved ones is the primary goal, life insurance can play an integral part in your overall financial plan.

TRIPLE THREAT

Three reasons why life insurance can help protect and grow your family's wealth.

Overview

As financial professionals, we often meet people who have questions about whether or not they should keep older life insurance policies or take one out for the first time. They frequently ask us things like:

- "Our kids are grown and gone. Do we still need life insurance?"
- "Should I be investing the premium payment in my retirement account instead of paying for a policy?"
- "How much life insurance do I need to purchase?"

These are all valid questions, and the answer varies, depending on your specific life situation. In the following, we're looking at three reasons to own life insurance and some of the ways it can help protect your family's future.

Life Insurance Basics

Life insurance is there in case you ever are not. When you purchase life insurance, you are essentially making a deal with an insurance company to trade payment — known as a premium — for the guarantee that it will pay your beneficiaries a set amount upon your passing. This is known as the death benefit, and all guarantees are based on the claims-paying ability of the insurer. Beneficiaries receive life insurance benefits tax-free and can use them however they wish.[1] They may use proceeds to:

- Maintain their current lifestyle
- Pay off a mortgage or other debt
- Attend college
- Fund a retirement nest egg

For the policy owner, life insurance can provide a sense of confidence that loved ones will be financially provided for should something happen to him or her. Although life insurance can be used to address a wide variety of financial issues, family financial well-being is generally its most important feature.

Three Reasons to Own Life Insurance

Although protection is an attractive feature for many life insurance policy owners, the ability to grow wealth is also an important benefit. Here are three reasons many people may purchase life insurance:

Reason No. 1: Replace Lost Income in the Future
We can all attach some sort of economic value to our lives, whether we're a breadwinner or caregiver. What will it cost our families if our ability to provide an income or care goes away?

The term "economic lifetime value" (ELV) refers to the lifetime sum of earned income you would receive if you do not pass away before retirement. Replacing lost future income is probably the No. 1 reason someone would consider buying life insurance.

For example, if your base salary is $80,000 a year and you plan to work for another 30 years, your base ELV is $2.4 million ($80,000 x 30 years). And that's just the base; it doesn't account for future raises, performance bonuses, etc. It also doesn't consider your expenses, long-term inflation, etc.

If you die, that projected $2.4 million won't be available to cover your family's future living expenses. They may also have a shortfall in saving for retirement or covering the cost of college. A life insurance policy could help make sure your family has access to the funds they need to continue your current lifestyle while also providing for their future expenses.

Reason No. 2: Pay Off Expenses
The next reason to consider purchasing life insurance is to pay off liabilities after you pass away. Initially, you should have enough coverage to pay for final expenses. Funeral arrangements can easily run to $8,500 or more, so life insurance can leave your heirs with money to handle those expenses.[2]

Besides final expenses, you may wish for your beneficiary to pay off the mortgage or fund the purchase of a home. Maybe you'd like to pay for college tuition for your children or grandchildren. Perhaps you had always planned to pay for your child's wedding (or multiple kids' weddings).

Another common scenario is for business owners to use life insurance to pay off business debts in the event of their passing. Business partners will often create what's called a buy-sell agreement. This agreement simply asserts that if one partner were to pass away, the other would buy the deceased's portion so that the business can remain viable.

By using a life insurance policy to facilitate that transaction, not only can the surviving partner continue to earn a living, but proceeds from the sale go to the deceased's loved ones to help secure their financial future. It also helps to avoid the situation of the partner trying to co-manage the business with the deceased's family.

Reason No. 3: Asset Management Tool
A third reason to purchase life insurance is one of the most overlooked and lesser-known uses: It can be used as an asset management tool as part of your savings or investment portfolio.

When most people think of accumulating wealth, they think of stocks, bonds, mutual funds, ETFs, etc. But life insurance can be used to enhance wealth as well.

Here's a hypothetical example in which a 65-year-old woman uses a life insurance policy to augment her financial portfolio. She has accumulated roughly $1 million in her investment portfolio and decides to withdraw $15,000 a year to pay annual premiums toward a $1 million life insurance policy.

Imagine this woman lives for another 20 years and therefore pays a total of $300,000 in premiums ($15,000 x 20). When she passes away after 20 years, her beneficiaries will receive a total of $1 million from this policy.

If it seems questionable to pay that much over 20 years, consider what she might have otherwise done with the money. Had she contributed the $15,000 every year into a traditional investment, she would have needed about an 11% annualized rate of return to reach $1 million after 20 years. To reach that sum after taxes and fees, she would need to earn an even higher rate of return.

That's not an entirely realistic rate of return. For example, the S&P 500 averaged an 8.5% return in the 20 years from 2005 to 2024. And investment performance is by no means guaranteed; returns ranged from -36.5% to +30.2% during that same period.[3]

Investment returns may also be subject to taxes. Not only are life insurance proceeds not subject to income taxes (although they may be included as part of the policy owner's estate for estate tax purposes), but they also are guaranteed by the insurance company.

Concerns and Caveats

When it comes to purchasing life insurance, there are caveats. The older you are, the more expensive the premiums are. Life insurance also requires medical underwriting, so people who suffer from certain health conditions may be denied coverage. Premium rates are determined by the applicant's age, lifestyle and current health status.

For permanent life insurance policies, there could be penalties should you need to withdraw or access the funds before beneficiaries receive the death benefit. Withdrawals or surrenders made during a surrender charge period may be subject to surrender charges and may reduce the ultimate death benefit and cash value.

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Many employers offer life insurance coverage, generally at competitive group rates. However, the coverage is typically limited to one to three times the employee's annual salary. Therefore, it is recommended that most households purchase an additional policy separate from work. This also is a good idea because employer coverage almost always terminates when you leave your job.

Final Thoughts

If you do not currently own life insurance, consider the many reasons it may be a good idea for your situation. If you do have a policy, recognize it is a complex financial tool that should be monitored and potentially adjusted periodically to reflect your changing life circumstances and objectives.

Whether you're considering your first policy or reassessing existing coverage, working with an experienced life insurance professional is important to navigating the complexities of different policy types and helping ensure your coverage aligns with your financial goals. By taking proactive steps today to address your life insurance needs, you're making a powerful commitment to help protect your family's financial future, preserve your legacy and potentially enhance your overall wealth management strategy for generations to come.

Sources
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