

GOODSON WACHTEL AND PETRULIS
A PROFESSIONAL CORPORATION
MEMORANDUM

TO: Goodson Wachtel and Petrulis
FROM: Kenneth G. Petrulis
DATE: October 7, 2010
RE: A Conversation on Life Insurance

Who Needs It?

Whether you need life insurance depends on a number of factors including your family situation, your financial situation, and your goals. Most commonly we think of life insurance as a means to provide for our families' financial needs when disaster strikes. However, older couples who no longer have ongoing financial burdens or younger couples whose family financial needs are well provided for often do not "need" life insurance. Even for such couples, life insurance, because of its unique financial and tax characteristics, is used as an investment to diversify the overall portfolio of family investments.

What Type of Insurance is Best?

Younger families typically seek out life insurance to ensure that, if one of the spouses dies, their services, either at home or in the workplace, can be replaced using the proceeds of the life insurance. Usually, term insurance, the least expensive form of insurance, is used. With careful shopping, the sales commissions for such insurance will be minimized and the cost of the insurance will closely reflect the risk portion of the product, i.e. the actual life insurance. The cost of term insurance increases based upon age and other factors affecting insurability, such as disease, accident, etc. For the family that can afford it, some type of whole life or variable life product provides more protection. These products include an investment component in addition to the insurance component.

Life Insurance is a Bundle of Services

Life insurance, other than term insurance, consist of essentially four distinct services bundled into a single package which is marketed and sold without disclosing the pricing of the individual services. Sophisticated buyers of life insurance, however, often demand and receive an itemization of the costs of the various services. As a result, those sophisticated buyers are able to negotiate the costs of those services.

The cost of life insurance includes four components: (1) the risk or term life component; (2) an investment vehicle; (3) a sales commission; and (4) administrative services. In addition to the term insurance component, whole life or variable life include an investment vehicle where a portion of the premium is invested by the insurance company. Those investments are used to either guarantee that insurance rates will not change or gains and losses are shared in whole or in part with the insured. They are typically marketed as a means to reduce future premiums or increase future coverage. However, they also include the very real possibility of loss of investment which would result in increased future premiums or decrease in coverage.

The third component of life insurance, the commission, often consumes much of the first year's premium. It is a recurring yearly cost which decreases over time. The final component, the administration fee, covers the cost of investment advice, overhead, billing and overseeing the program. These costs, when itemized by the insurer in the insurance proposal, enable the consumer to make informed decisions and to negotiate the best price for the insurance.

What Investment Advantages Does Life Insurance Provide?

Insurance differs from other investments in that the face amount of the policy is a guaranteed return. Second, the return or profit on investment is free of income tax.

Third, there are relatively straight forward methods for ensuring that the proceeds of the life insurance will not be subject to estate and gift taxes. The combination of these factors makes life insurance not only a good investment, but also a means to diversify an investment portfolio. Insurance provides income at a time when it is most needed, i.e. in the event of a sudden death, or in the short term at the time taxes must be paid. It is a secure investment providing either a high rate of return over the short term or protection over the long run with a lower rate of return. In either situation, the special tax status of the insurance and its security make it a good investment.

How Does a Life Insurance Trust Help?

Life insurance held in a life insurance trust should be part of your overall estate plan so long as you have the health and financial resources to afford it. Holding a life insurance policy in a trust protects the policy by helping to avoid estate taxes on the proceeds and protects the policy and proceeds from creditors. Using our services we can help you negotiate with the life insurance company to reduce the cost of the life insurance, to reduce or eliminate the cost of the life insurance trust, and to maintain the life insurance trust so that the proceeds of the life insurance will pass tax free to your family.

If you are at that point where you are considering how to diversify your investments as well as provide protection for your family or if you need to think about avoiding estate taxes or providing a tax free source for paying estate taxes, we invite you to call us.