NORTH CAROLINA BAR ASSOCIATION
SEEKING LIBERTY & JUSTICE

THE WILL & THE WAY

Published by the NCBA's Estate Planning & Fiduciary Law Section Section Vol. 28, No. 1 November 2008 www.ncbar.org

Life Insurance: How Much is Enough

Clarifying the need drives confident results

By Kenneth R. Samuelson and Brandon W. Davis

Welcome to part three of our series on Life Insurance Capacity. Our goal is to provide advisors with the right tools to evaluate clients' life insurance decisions – those made long ago and those yet to come. In this article, we focus on the present. A sharp, effective need assessment tool can help make sure that the client has the right amount of insurance at the right price to meet today's requirements.

So, how much is enough?

We are all concerned about spending money wisely, and sometimes this spills over into the insurance discussion. When it comes to estate planning, the attorney is usually cast as the primary 'trusted advisor' for clients. Good questions are the currency of good advice, and good questions are in order when it comes to life insurance. Questions like: Does my client really need life insurance? If so, how much? Does my client have too much (or too little) coverage? Is the existing portfolio of life insurance efficient, or is my client overpaying? Is there something better out there? Should my client have term insurance instead of this dusty, 20-year-old whole life policy? If I call the agent for advice, will I create a maelstrom of confusion in the process?

Attorneys tell us that what they value most in an insurance professional is the ability to identify the need for insurance with clarity and truth. These diagnostic skills are very important, and when coupled with planning creativity, excellence in completing the transaction and superior ongoing service, the insurance professional can make a meaningful contribution to the client's planning process. A key to success in any area of business is to systematize where appropriate.

The Systematic Evaluation of Insurance Capacity: ICE Method

In the February 2008 issue of *The Will & The Way*, we overviewed the ICE Method, a framework for assessing a client's financial and medical ability to acquire life insurance. Fundamentally, the ICE Method serves as a meaningful way to break down the discussion about a client's current and future life insurance needs, including In-force coverage, Coverage needed, and Excess capacity.

I: **In-force coverage.** This represents the client's already-existing life insurance policies. Older polices merit review on a regular basis. Factors driving the need to evaluate existing coverage include changes in the client's health or financial circumstances or simply the passage of time. As new product offerings improve, clients should periodically re-evaluate their coverage by having policies tested for competitiveness and cost-efficiency. For a detailed look at methods to evaluate in-force policies, review the May 2007 issue of *The Will & The Way*.

C: **Coverage needed.** This represents any additional coverage the client may need to complete or complement the current estate plan. Below we address the methods and logic behind determining the client's insurance need. We conclude by summarizing the systematic process for the design, implementation and administration of life insurance portfolios.

E: **Excess capacity.** This represents any untapped insurance capacity that the client wants to keep available for later use, but does not need currently for estate planning or business purposes. In other words, clients may want to purchase insurance now, while they can qualify for it, simply to 'warehouse' it in the event a future need arises. For additional commentary on capturing and funding excess insurance capacity, we refer you to our article in the February 2008 issue of *The Will & The Way*.

The Need for Life Insurance

As advisors open the planning process, one of their most important tasks is to help

See LIFE INSURANCE *page 2*

THE WILL & THE WAY

VOL. 28, NO. 1 NOVEMBER 2008

Published by the NCBA's Estate Planning & Fiduciary Law Section

Life Insurance *from page 1*

clients clearly articulate their goals. When the topic turns to insurance and intergenerational wealth transfer planning, they must skillfully help clients assess the potential needs for life insurance. If the need is well-defined, clear and compelling, the overall process will gain the early momentum necessary to carry through to successful completion.

Traditional View: Life Insurance as a Funding Tool

Life insurance is not an end but rather a means to achieve the goals and wishes of the client's heart. Unlike other assets, life insurance matures as a liquid asset, at full value, at death. With proper implementation, life insurance proceeds, when paid out, can instantaneously address an unfunded liability or create a desired result that is important to the operation of the client's estate plan. Knowing the client's goals and the critical sequence of events that needs to happen at death is the first step in the process. The possibilities are endless, but commonly articulated needs for life insurance are:

- **Estate liquidity:** creating cash to pay estate transfer costs.

- **Debt repayment:** funding liabilities that need to be paid in the event of death.

- **Inheritance equalization:** creating a means to bring balance when heirs receive different amounts or types of assets as part of the estate plan.

- **Income replacement:** providing a stream of income to replace lost income or assets at death.

- **Charitable bequests:** addressing philanthropic interests at death.

- **Stock redemption:** assuring that stock in the family business gets into the correct hands at death.

Emerging View: Life Insurance as an Asset Class

Increasingly, advisors view life insurance as an alternative for helping to maximize delivery of tax favored benefits to subsequent generations. For many families, this is a central goal around which many other goals revolve. Life insurance serves as an effective means of diversifying the form and timing of how these benefits are delivered. Consider the following ways that life insurance, as a result of its unique attributes, serves to diversify the client's intergenerational wealth portfolio:

- **Asset class diversification:** By necessity, the value of life insurance does not fluctuate in step with other assets in the client's portfolio. This is particularly true of policies with guaranteed premiums and guaranteed death benefits issued by strong insurance companies. The ultimate financial return of a policy for beneficiaries is unrelated to other aspects of the financial markets because it is driven by the insured's mortality.

- **Strategy diversification:** Life insurance is a strategy unto itself and can serve to complement and diversify other strategies for moving wealth between the generations. A well executed insurance plan can provide reliability and predictability and can also enhance the effectiveness of other planning strategies.

- **Mortality diversification:** Life insurance counter-correlates to other strategies that mature over time (a GRAT, for example). Insurance works well (for purposes of wealth transfer to heirs) if the insured dies early, statistically speaking. In other words, the client has paid disproportionately few premiums for the benefit received by the heirs. This is the nature of insurance.

- **Liquidity diversification:** Wealthy families can and often do use life insurance to diversify how the family will raise liquidity at death. Life insurance prevents the family from holding excessive cash reserves, especially in the short-term, to address estate liquidity needs. With the life insurance liquidity plan in place, other investment assets are more freely invested in illiquid form for the long-term.

Implementation: Turning Theory into Reality

As articulated, life insurance acquisition decisions should be driven first by need. We now turn our attention to the design, installation and administration of effective insurance solutions. The Life Insurance Confidence System℠, outlined below, will enable you to guide clients through a simple, understandable, straightforward process for addressing life insurance needs. It can serve as your insurance implementation roadmap on behalf of your clients.

The steps of the system follow those of any good financial planning tool. Think of it as a funnel. The top of the funnel is open to every possibility. During each step of the process, narrow down the choices and alternatives until you arrive at a result that is sound, achievable and able to be implemented. Following this process can help ensure successful integration of life insurance into the client's overall plan in an orderly, systematic way.

The Six Step Process.

Step 1. Assess the overall need – ask questions, gather information and formulate the desired end result.

Step 2. Design the concept – develop a broad plan to address the expressed need. Decide what role insurance should play as a traditional funding tool and as a diversification method.

Step 3. Survey products – find specific products that fit the overall design. Then test the price across a broad array of insurance carriers, taking into account carrier strength metrics. In today's uncertain financial climate, long-term strength metrics may override pure cost considerations.

Step 4. Optimize underwriting – gather medical and financial information for the purpose of negotiating competitive rate classifications from the insurance providers. Rate classification is the final, and most influential, determinant in actual pricing.

Step 5. Fulfillment – complete and fully document the transaction.

Step 6. Administration – monitor the plan annually and keep all parties informed.

The Bottom Line

Clients want help navigating the world of life insurance for estate planning. The ICE Method can prove to be a useful navigational tool, because it takes into consideration the utilization of all of the client's insurance capacity. In short, it provides for evaluating In-force policies from the past, Coverage needed for current circumstances and Excess capacity alternatives for the future.

The Life Insurance Confidence System℠ provides a framework for the design, implementation and administration of life insurance. The process begins with assessing and clearly articulating life insurance needs. Advisors should consider needs from both from a traditional point of view, i.e. to fund a liability, and from the point of view that insurance can be a distinct 'asset class' that complements the overall intergenerational wealth portfolio.

Many clients have concerns about past life insurance decisions and confusion about current and future needs. A disciplined approach based on systematic methods can bring clients clarity of thought and confidence in action. ■

KEN SAMUELSON AND BRANDON DAVIS ARE PRINCIPALS AT THE MOREHEAD GROUP INC., A FINANCIAL SERVICES FIRM IN CHARLOTTE SPECIALIZING IN LIFE INSURANCE FOR HIGH NET WORTH INDIVIDUALS AND FAMILIES. THEY CAN BE REACHED VIA PHONE (704) 334-2700 OR E-MAIL KSAMUELSON@MOREHEADGROUP.COM, BDAVIS@MOREHEADGROUP.COM.