The Business Library — Resource Report #41

20 Ways to Reduce and Effectively Use Insurance Premiums

Getting the Most Bang from Your Insurance Dollars

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- Buying New Life Insurance
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Are the dollars you're paying out in premiums buying you the *most* and *best* insurance coverage available and at the *least* cost?

Getting the Most Bang
From Your Insurance Premium Dollars

The payoff for careful insurance planning can be considerable. When you reduce a premium, *it's not a one-time reduction*. The savings accumulate over all the years of coverage. On $10,000 of annual premium payments, a 20% savings of $2,000 that you implement today delivers $20,000 savings over 10 years and $40,000 over 20 years. And those savings are in addition to the interest earned by the money that's now in your pocket, not the insurance company's.

Here is a checklist of ideas to help you get the *most* insurance protection at the *lowest* premium cost. You might decide to revise the coverage you have, the premiums you pay, and the way you pay them. We have included some business ideas for those readers who own part or all of a business or operate a business from their homes.

Quick-Hit Checklist

#1. Reduce the amount of your life insurance if your need to protect dependents has declined. Or you can restructure its use, e.g., use a personal policy for business purposes, such as a buy-sell agreement, or designate your grandchildren or a charity as the beneficiaries instead of your grown children.

#2. If you're in good health, push for a *preferred rating* on new policies; the premium is substantially lower for each year the policy is in force. Furthermore, don't smoke. The added premium cost for smokers can be as high as 30%.

#3. Consider replacing old life insurance policies with new lower-cost term, permanent (whole life), variable, or universal life insurance policies but only *after* you determine the annual net cost of the older policy. You don't want to cancel a policy whose annual premium is completely offset by the dividend and increase in the policy's cash value. Also, don't replace or cancel an existing policy until the new policy is issued just in case the new insurer finds you uninsurable or will only issue a rated policy with a higher annual premium.

#4. Minimum deposit your life insurance if your cash flow is tight. That involves using your dividends and borrowing against the policy's cash value to pay some of the premium. But be careful. Remember that policy loans must be repaid, including interest, or the amount owed will be subtracted from the death proceeds.

#5. Consider lower-cost, *second-to-die* life insurance on your and your spouse's lives to provide for your children and pay federal and state estate taxes if that is a potential problem.

#6. If you need more life insurance to provide for children until age 21, consider buying inexpensive term insurance. But make sure the policy is convertible to a permanent policy just in case you need the insurance in future years for another use. For more information on term insurance, please see page 8.

#7. Refrain from buying credit or travel life insurance. The same amount of premium can buy you more term or permanent coverage.

#8. Take maximum advantage of your policies' dividends. Collect them in cash, apply them to the purchase of more life insurance if that's an option, or use them to reduce your annual premium. For more information on the use of your dividends, see *Exhibit 1,* page10.

#9. If you're *under*-insured or have a limited amount of money to pay insurance premiums, consider buying term life insurance. You can convert the term insurance to a permanent policy later if your need for the life insurance becomes permanent.

#10. Don't purchase on-line life insurance **without** obtaining an illustration of the annual *projected* premium cost, dividends, and increase in cash value. Then review the illustration with your life insurance agent and accountant to determine the net cost of the insurance.

#11. Do not **cancel** any life insurance without first determining the annual net cost, i.e., the annual premium less the annual build-up in cash value plus any annual dividends. *Reason:* You may find that the policy is not costing you as much as you think. To determine the net cost, request what is called an **"in-force illustration"** from your agent.

#12. Eliminate the risk of your life insurance unintentionally lapsing for nonpayment of a premium within the 31-day grace period. Notify the insurers on *all* policies that the cash value of the policies (or any earned dividends) are to be *automatically* used to pay any missed premiums.

#13. Cashing in or cancelling an annuity contract or life insurance policy can result in substantial taxable income and, possibly, tax penalties for early termination. Get a letter from your agent and insurance company on the tax consequences *before* taking such action.

#14. Consider setting up a life insurance trust to provide income to your spouse and children and lower potential federal and state estate taxes. For more information on a life insurance trust, see page 8.

#15. Before purchasing any life insurance policies, shop around; get comparative cost data. The life insurance market is very competitive. But do select insurance companies with excellent industry ratings and comparatively high investment returns.

For Business Owners and Executives

#16. To lower business insurance costs, look into *split-dollar* insurance for you and executives so the company is eventually reimbursed for all or most of the premiums it pays through its share of the policy's cash value.

#17. Don't *over*-insure key executives; consider using a formula of three to four times their annual salary.

#18. Have the company pay any premium for life insurance coverage which is tax deductible. *Example:* Life insurance in retirement plans.

#19. Consider using *first-to-die* life insurance to fund a buy-sell agreement covering more than one owner's life. It's usually less expensive than two permanent or universal policies.

#20. Check out purchasing life insurance through business associations; it can be less costly. See *Exhibit 3* on page 12.

Avoid These Big-Dollar Mistakes

■ **Recheck life insurance beneficiaries.** Be sure your policies reflect the full name and relationship of all beneficiaries. For example, naming "my children" may cause a great deal of confusion if there are stepchildren, adopted children, or children by two marriages. There also have been instances where a younger child, never added to the beneficiary list, was excluded from all life insurance benefits.

■ **Provide for contingent and tertiary beneficiaries.** Naming your spouse as *sole beneficiary* is never a good idea, even if both of you are in good health. You should exercise your right to name contingent beneficiaries to assure that if you and the primary beneficiary die in a common accident, the insurance proceeds will go to the second person you would have selected.

What to do: Discuss with your insurance agent the need for and use of a common disaster clause and the designation of primary, contingent, and tertiary beneficiaries.

■ **Review all life insurance for status changes.** You could be making a mistake if you're still carrying the same amount and type of life insurance coverage you took out 20 years ago even though your children are now grown, your assets have increased, and your spouse has been provided for by your will or trust.

When should you consider making a change in your beneficiaries? Any time you make a change in any of your other estate components (e.g., your trust, will); any time there is a change in your family caused by birth, death, marriage, or divorce; or if you move to another state.

Reviewing your entire estate package, including your will and insurance policies, *at the same time* also ensures that all your intended heirs will be treated fairly. *Example:* If you have given one child money to buy a house, you may decide to name another child as the beneficiary of a life insurance policy as a way of equalizing your gifts to them.

■ **Retain flexibility on beneficiary designations.** Be cautious about naming any beneficiary *irrevocably.* You will have to obtain that individual's permission to change beneficiaries in the future or to borrow against the equity (cash value) you've built up in the insurance policy. You also may want to alter your policy in the future to protect your natural children if you are married a second time to a spouse with children of his or her own.

Retain further flexibility by doing the following: (a) To meet different objectives or provide for different groups of heirs, use different life insurance policies. One policy may cover a specific child's education, another may name grandchildren as beneficiaries. (b) To prevent misuse of the insurance money, particularly when young adults are the beneficiaries, consider including provisions for paying out insurance proceeds gradually or for providing for a waiting period before the entire amount is paid out.

■ **Switching and cancelling policies.** Don't switch or cancel any policy without first considering these cautions.

- The annual increase in the cash surrender value of an *existing* life insurance policy may be near or greater than its annual premium. In effect, you are building equity and borrowing power every year you pay the premium on this existing policy.

- The annual dividends paid on the *existing* policy also could be near or equal to its annual premium cost. This means your *net* premium cost (after dividends) for the policy is nominal or very low. *(Note:* This is particularly true on policies issued many years ago.)

- There is a two-year contestability provision on new life insurance policies. This provision gives the insurance company the right to contest an insurance claim if there were any material misrepresentations on the application, especially the non-disclosure of pre-existing medical problems.

■ **Coordinate life insurance with your will.** A carefully worked out estate plan can go awry if life insurance is not considered. For example, a forgotten insurance policy, naming one child as beneficiary or contingent beneficiary, can upset an otherwise equal distribution among your children. The same policy might result in an outright gift when your intentions, and the provisions of your will, are to provide equally to your children.

Use of Term Insurance

Buying term life insurance is a wise move for many individuals. The premium is lower than whole life, variable, and universal policies and it can fill big gaps in one's overall insurance protection. However, it is *not* permanent insurance, so you have to be very careful on how long you keep term insurance before converting the policy to permanent insurance. You also must periodically review *existing* term policies so you don't overlook certain options which expire over time, e.g., your right to convert to whole life or other permanent insurance.

Questions to ask: For how long is the term insurance convertible to permanent insurance — 5, 10, or 20 years? Is the life insurance effective to death or only to a certain age, e.g., age 65? Are the premiums guaranteed against annual increases? Is convertibility to permanent insurance contingent on a medical exam?

What to do: Call your insurance agent and get answers to the questions posed above. Also consider converting your current term insurance coverage to permanent insurance which usually does not require a medical exam for conversion. *Reasons:* You don't want the insurance coverage nonrenewable or cancelled by the insurer when you need it most. You also don't want substantially higher premiums later on if you decide to convert the term insurance to permanent insurance. As a general rule, if you know you will be converting a term policy to permanent insurance, do it as soon as possible. That way, part of the premium goes to the build-up in the policy's cash value.

Use of a Life Insurance Trust

You can provide for your family and substantially lower the value of your estate by *not* personally owning life insurance policies which would be included in your estate and potentially taxed. An insurance trust can own the policies and be the beneficiary for your spouse and children. The trust can provide annual income to your spouse with cash benefits (the principal) payable to your children upon his or her death. You also can structure the trust to permit your spouse to withdraw from the principal for medical emergencies and the children's educations.

Here's a simple example: If there is a $400,000 life insurance policy in the trust and it earns 4% after taxes, your spouse receives $16,000 annual income and has the ability to withdraw each year about $20,000 (5% times $400,000) for medical emergencies and support. That's a total of $36,000 annual income. Furthermore, you have lowered the value of your estate by $400,000 and reduced potential federal and state estate taxes.

Don't rush into an insurance trust: Project your spouse's cash needs after your death. Calculate the after-tax liquid (cash) value of your own estate and add to that amount your spouse's liquid assets. If the total is not enough to support your spouse through his or her life expectancy, forget about the insurance trust. You don't want to make the avoidance of taxes a high priority when your assets are needed to meet the future cash and lifestyle needs of your spouse. An insurance trust is an option only when you have assets in *excess* of what your spouse can reasonably be expected to need or spend in his or her lifetime.

* * *

What to do: Check off those ideas which are applicable to you, your family, and business. Then call your life insurance agent, accountant, and estate planner to discuss them and to schedule a review of what insurance you have, what you need, why and how long you'll need it, and what you want or can afford to pay. ☐

References

Exhibit 1: Options on Using Dividends, page 10.

Exhibit 2: Protecting Against Disability, page 11.

Exhibit 3: Business Association Insurance, page 13.

Exhibit 1

Options on Using Dividends

Dividends on life insurance policies are paid by an insurance company based on its mortality experience, expenses, return on investments, and its accumulated reserve account. In order to properly use your dividends, you must determine the amount that is being paid now or projected by the insurer and the options you have to receive or apply those dividends to another use.

The options available to most policy owners are as follows:

#1. Receive the dividends in cash. These dividends are usually considered a refund of premiums paid and normally are *not* reported as income for tax purposes.

#2. Use the dividends to reduce your annual premium outlay.

#3. Let the dividends accumulate at interest. While the dividends themselves are not regarded as current taxable income, the *interest* paid on them is taxable in the year earned, just like interest on savings accounts.

#4. Use the dividends to reduce outstanding policy loans.

#5. Use the dividends to buy term insurance in an amount equal to the cash value of the policy, then use the balance of any dividends for one of the options above.

#6. Use the dividends to buy paid-up additions to increase insurance coverage and the policy's cash value. *Note:* Dividends allowed to grow under this option are *not* taxable income in the year earned. They only become taxable for the amount that exceeds the total premiums paid if the policy is terminated or cashed in.

Note: Numbers 5 and 6 apply to the issuance of new life insurance policies; however, the options may be available in existing policies but subject to a medical examination. Check with your insurance broker; these options are particularly important if you could use more life insurance coverage, e.g., your children are young and you're the primary wage earner. In contrast, if your need for life insurance has decreased, you may wish to take the dividends in cash. □

Exhibit 2

Protecting Against Disability

Disability insurance to protect your income is important coverage, but it can be very confusing insurance to buy. If you don't already have disability coverage, use the ideas below to choose the best policy. If you currently have coverage, use the ideas to review your current policy with your insurance agent; you may want to make some changes.

Here's the biggest reason to consider disability coverage: Seven out of ten men between the ages of 35 and 65 become disabled and are unable to work for periods of 90 days or more. For women, the statistic is four out of ten.

Costs and terms. The cost for a $3,000-per-month disability benefit ($36,000 annually) is relatively low. For 40-year-old executives (Unisex Ratings), the annual premium cost is about $1,000 for a $36,000 annual benefit with a 60-day elimination period. For 50- and 60-year-old executives, the cost increases to $1,400 and $2,000 a year, respectively.

However, before you buy the insurance, you have important decisions to make on the type of policy, level of coverage, and the elimination period, i.e., the length of time you must wait before receiving the benefits. You have a variety of options to choose from.

Here are ideas to discuss with your insurance agent to be sure you're adequately protected on both new and existing policies.

1. The policy you currently own or buy should be *noncancellable* and *guaranteed* renewable. This is very important; you don't want the insurance cancelled when you need it most.

2. You should have sufficient cash reserves to wait out the elimination period. It can be 60, 90, 180 days, etc.

3. Don't rely *solely* on income from sources such as Social Security and other federal or state programs (e.g., veteran's and worker's compensation). Use these programs as a *supplement* to your basic disability insurance.

4. If you want to *lower* your annual cost on an individual policy, consider the following:

- Reduce the monthly benefit amount, but only if you have excess cash to ride out a disability.

- Make the elimination period as long as possible (say, six months to one year). This, again, while it reduces costs, also increases the need for personal resources to ride out the waiting period.

5. *Important questions:* Do I want coverage to protect myself for *any* type of work or just my occupation? And for total or partial disability? What is the definition of disability? Generally, you want the following definition in your policy:

> **Your inability to perform the substantial and material duties of your *current* occupation.**

That's the best definition. Others may define it as: *Your inability to work in an occupation which you can perform based on your past education, training, and experience.* That's more limiting than your *current* occupation.

Another option: Many insurance companies provide coverage for benefits based on the decline in earnings due to disability. *Example:* Your monthly income drops from $6,000 to $2,500 because of disability. A percentage, usually 66%, of the $3,500 difference is the monthly disability paid to you.

* * *

Disability coverage is important protection and often overlooked. Use this advisory as a first step in *updating* your present coverage or *obtaining* the new coverage you need. ☐

Exhibit 3

Business Association Insurance

If available, always consider buying personal and business life insurance, including group insurance, from business associations. *There are several reasons:*

- Business associations have a variety of business and personal insurance products to meet many of their members' needs, e.g., buy-sell, key executive, health, and disability insurance.

- The annual premium cost can be lower than on individual policies, and term and group life insurance policies usually can be converted to permanent insurance.

- Since the association's members represent a "group" of potential insureds, you may find that the requirements for *proving insurability* are less than on individual policies. That can be a significant advantage if your health is not good.

What to do: Request information on your association's personal and business insurance programs. Decide what additional coverage you need and what current coverage you can replace at a lower cost. Your association's insurance representative will help you prepare comparative cost data for *both* new and replacement insurance policies. ☐

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