LION STREET®

Silver Linings of Life Insurance Planning During the COVID-19 Storm

INTRODUCTION

The COVID-19 pandemic has caused a severe thunderstorm for the global economy and stock markets, with clouds of financial uncertainty lingering over our society.

Around the edges of the clouds, though, are silver linings created by the sun shining behind them. Life insurance can bring emotional and economic security and flexibility for individuals, families and businesses with respect to their financial, estate and business planning.

This commentary highlights several "silver linings" of life insurance planning for helping policy owners endure current financial challenges as well as prepare for those that may lie ahead.

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TOPICS

FINANCIAL SECURITY UPON THE INSURED'S PASSING

FINANCIAL FLEXIBILITY DURING THE INSURED'S LIFETIME

POLICY-SPECIFIC SILVER LININGS

ACQUIRING NEW COVERAGE WITH CONVENIENCE

FINANCIAL SECURITY UPON THE INSURED'S PASSING

If required premiums have been paid, the face amount is in effect which provides valuable protection that typically does not fluctuate due to volatility in the financial markets.

A death benefit that stays constant helps ensure financial protection and stability for beneficiaries if the insured passes away during times of economic downturns or uncertainty by addressing needs such as replacing lost income or retirement benefits, funding college tuition, repaying debts, paying estate taxes, mitigating costs of the death of a key employee, funding the ownership transition of a closely held business, and more.

Death benefit proceeds can help replace the value of assets lost during a downturn, should the insured pass away during or thereafter.

Whether personal net worth consists of marketable securities, privately held companies, or otherwise, recessions or bear markets can cause personal assets, and/or cash flow therefrom, to erode leaving less wealth to loved ones for future financial security or as a financial legacy. The death of a breadwinner could exacerbate this increased protection gap further due to lost future income and corresponding wealth accumulation. Payment of death benefit proceeds can help fill this gap and offset volatility in other assets by restoring a family's current and would-be future wealth, avoiding a forced sale of assets at a loss or when depressed in value and/or allowing time for other assets to recover while maintaining financial security.

The rate of return on premiums paid attributable to the death benefit and its low-risk nature can make the policy an attractive wealth transfer "asset class."

For those that want to leave a financial legacy to loved ones, the rate of return realized can be competitive with other types of assets available for wealth transfer, depending on when the insured passes away. Moreover, the low-risk and predictable nature of the death benefit, the payment of which is correlated to mortality and not the markets, can help reduce risk in one's estate or trust assets and potentially increase risk-adjusted return with respect to his or her financial legacy to familial beneficiaries.

FINANCIAL FLEXIBILITY DURING THE INSURED'S LIFETIME

Borrowing from the cash value can provide an efficient, income tax-free source of supplemental income.

In addition to competitive long-term accumulation potential, the cash value can provide a source of liquidity to fund short-term needs via policy loans. Interest can be accrued and the loan can be repaid during life, to restore accessible cash value and future accumulation potential, or from the death benefit proceeds upon death. Borrowing reduces the net cash value and death benefit, can affect the policy's performance and a portion or all the loan could be taxable if the policy lapses during life, or ever becomes a Modified Endowment Contract (MEC), so careful monitoring is required.

Policies with a Chronic Illness or Long-Term Care (LTC) Rider can provide a tax-efficient way to help pay related expenses.

Roughly 70% of retirees may develop a condition requiring long-term care and the unexpected costs of such care can be high. Having to sell assets to pay for care can have income tax consequences and erode a family's wealth quickly especially when asset values are depressed due to an economic downturn, which can pose significant risk to one's retirement planning. Assuming the insured meets the eligibility requirements, a policy with such a rider can allow the owner to accelerate portions of the death benefit income tax free to pay for LTC expenses, thus protecting other assets and providing flexibility to the insured's family who are often the primary caregivers.

Selling a policy to a life settlement company can help maximize the monetary value of the policy and create a source of liquidity.

Assuming the insured has a short enough life expectancy, the policy could be eligible for sale in the settlement market. A life settlement company may buy the policy for cash, often exceeding the current cash value, which can help provide liquidity to the owner to fund other needs if the coverage is no longer needed. In some cases, even a term policy may be eligible for settlement if it is convertible to a permanent one. Note, selling the policy to a third party may have income tax consequences if the amount realized exceed the owner's cost basis in the policy.

POLICY-SPECIFIC SILVER LININGS

NO-LAPSE GUARANTEE (NLG)

NLG premiums for a Guaranteed Universal Life (GUL) or Guaranteed Variable UL (GVUL) policy will not change due to interest rate or stock market volatility.

Planned premiums for traditional "current assumption" UL or VUL policies are based on non-guaranteed policy charges and credited interest rates tied to current expectations for mortality, operating and investment experience (fixed-income investments for UL; stock market investments for VUL). If experience in these three areas varies from what was priced and assumed at issue, the carrier can adjust these non-guaranteed elements which may cause planned premiums to increase or decrease. NLG premiums for GUL or GVUL policies, though, are based on contractually guaranteed assumptions for mortality, operating and investment experience. Therefore, current and future premiums will remain constant assuming all premiums are paid on time and in the required amount. In other words, the carrier assumes all mortality, operating and investment risk and cannot change the guaranteed premiums due to adverse experience in these areas.

INDEXED UL (IUL)

The downside protection element of an IUL policy can help protect the cash value against the effect of negative market returns while preserving upside potential when the market recovers.

An IUL policy credits interest to the cash value at a rate linked to the growth of a stock market index (excluding dividends) over specific segments of time (beginning each month) within the range of a guaranteed minimum "floor" of 0% or 1% and non-guaranteed growth cap or participation rate. When the underlying index realizes a negative return, the cash value with a 0% minimum floor, for example, is only reduced by the amount of policy charges deducted therefrom and not exacerbated by negative market returns. Moreover, as the market recovers, the indexed account can benefit from a lower index price starting point for measuring the growth over subsequent segments ("reset" feature). In other words, the policy participates in the index gains up to certain limits without participation in its losses. Note, some IUL policies may have additional asset-based charges that "buy up" a higher cap or participation rate which will reduce cash value to a greater extent in down years than one without (with higher upside potential in segments where growth is realized).

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POLICY-SPECIFIC SILVER LININGS

WHOLE LIFE (WL)

The guaranteed cash value build-up of a WL policy can provide constant, uncorrelated and tax-deferred accumulation that can help offset volatility in other assets.

The base premium, tabular cash value build-up and death benefit of a whole life policy are guaranteed and unaffected by interest rate or market volatility. Participating whole life policies are eligible to receive dividends from the carrier based on surplus created by favorable mortality, investment and operating experience. If used to buy paid-up additions (PUAs), dividends enhance the tabular tax-deferred cash value (and death benefit). As a result, whole life cash value keeps growing and doesn't contract unless withdrawals/loans are taken or premiums go unpaid. Once dividends are credited, and PUAs purchased, PUA cash value keeps accumulating too unless other policy transactions or changes occur (interest rates may affect carrier investment returns which may affect the dividend declared but only prospectively, not retroactively). Moreover, this constant cash value growth and dividend participation are uncorrelated to the stock market, thus it can help hedge against volatility in other assets, reduce risk and add stability to one's portfolio during times of economic turmoil.

VARIABLE UL (VUL)

Continuing or paying more premium into a VUL policy during a market downturn can achieve strong cash value gains during the following recovery and enhance long-term performance.

VUL policies credit interest to the cash value based on the daily performance of variable (mutual fund-like) investments. Although cash value may decline due to negative investment returns during a downturn, stopping premiums during such time can exacerbate the negative effects, hindering future policy performance and increasing the risk of policy lapse. Continuing premiums during a downturn can help ensure the policy favorably benefits from the market recovery and remains on track to meet long-term goals. Paying additional premiums, if possible, during a downturn (adding to the underlying investments when valued at a market "discount") can help capture additional cash value gains when the market recovers. The biggest gains in the market, historically, have most often been immediately following downturns. Such performance boost can help reduce premiums, enhance cash value accumulation and/or reduce performance risk.

ACQUIRING NEW COVERAGE WITH CONVENIENCE

Many carriers are stepping up with digital, accelerated and/or streamlined underwriting procedures that can help facilitate the process while maintaining social distancing.

During this temporary time of social distancing, it can be challenging to apply and obtain the requirements needed by the carrier to underwrite the insured and issue a policy. Several prominent carriers now offer programs or processes that allow the insured to apply for the policy digitally, use medical records via patient portal access or comprehensive physicals by their physicians as replacements for traditional medical exams and lab tests. Present circumstances have forced carriers to re-evaluate underwriting requirements for policies up to a certain size and insureds up to a certain age based on satisfactory answers to medical history questions. Many of these options were available before the pandemic but have since been enhanced to help insureds continue to apply for and acquire coverage when in-person interactions may be limited.

Assess your life insurance needs and don't delay acquiring coverage.

Studies have shown most Americans are underinsured and challenging times such as these greatly reinforce the basic need for life insurance. Now may be a decisive time to ensure your family or business is adequately protected and life insurance needs are satisfied, possibly using one of the digital, accelerated and/or streamlined procedures, if eligible.

Click here for a helpful website to calculate the basic life insurance needs for family financial security.

Variable life insurance is sold by prospectus. Please consider the investment objectives, risks, charges, expenses, and your need for death-benefit coverage carefully before investing. The prospectus, which contains this and other information about the variable life policy and the underlying investment options, can be obtained from your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

The investment return and principal value of the variable life policy are not guaranteed. Variable life sub-accounts fluctuate with changes in market conditions. The principal may be worth more or less than the original amount invested when the policy is surrendered.

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515 Congress Ave., 25th Floor - Suite 2500 | Austin, TX 78701 | (512) 776-8400

www.LionStreet.com