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Seven Reasons For Life Insurance During Retirement

Want to sell financial products to baby boomers? The experts say you should talk to them about retirement planning. They say boomers will buy from you if you can show them how to retire without "down-sizing" their lifestyles. They will be interested in strategies and products that will help preserve their retirement nest eggs or provide reliable streams of income.

What about life insurance? If boomers' main goals are asset preservation and steady income, why will they need to buy new life insurance policies after they retire? That's the question insurance companies and agents will have to answer if they want to sell to boomers.

Part of the sales challenge will be to persuade boomers to change how they think about life insurance. During their working years most boomers purchased life insurance as an income replacement tool. They needed the death benefits to keep their families financially secure if they died prematurely. Policy death benefits could be used to pay off mortgages, provide funds for higher education, and retire debts. Unfortunately, many boomers with this mindset believe they no longer need life insurance after retiring. After all, they've paid off their mortgages, their kids are out of college and they are debt free. *Why will they need to keep their current life insurance policies, let alone buy new ones?*

Agents need boomers to understand that as they move into retirement, they are encountering new financial problems and risks. Retirement is a new stage of life that changes their financial goals. In retiring, boomers are moving out of the income replacement stage of their financial lives and into the asset protection stage. In this new stage they need to focus on preserving their net worth and managing it to maximize what it produces for them and their families.

In the asset preservation stage boomers no longer need life insurance to replace income that would be lost with their deaths. Even so, they may find that life insurance can help them preserve the retirement funds they've built and efficiently pass the balance on to their families when they die. *The unique features and tax treatment of life insurance make it a flexible tool for meeting many of their new financial goals in retirement.*

The Magnificent Seven

How can life insurance help retired boomers? There are at least seven ways death benefit oriented life insurance can help retired boomers meet their new financial objectives. This article focuses on life insurance death benefits. The cash value component of cash value life insurance policies can also be very advantageous, but those benefits are outside the scope of this article. Mastering these seven strategies will help you show boomers why they may want life insurance death benefits to preserve their retirement assets:

1. Reinforce A Spouse's/Partner's Financial Security. No one wants to die and leave their surviving spouse or partner in a precarious financial position. Unfortunately this happens all too often. Most couples start their retirement believing they will have more than enough money to live a comfortable lifestyle. But, as the years pass, events beyond their control can erode their retirement nest egg. Several unexpected developments could put their financial security in jeopardy:

Higher than expected inflation—the economy and the future cost of living can't be predicted with certainty; if inflation goes up unexpectedly (e.g., food or gas/energy prices go up), retirement funds may be spent at a faster rate.

Unanticipated medical costs—a spouse/partner may be in an accident or experience an illness that requires expensive medical care. Covering these extra costs could significantly reduce retirement savings, especially if the limits of health insurance coverage are exceeded.

Sub-par investment performance—some retirement investments or the economy in general may under-perform relative to what was expected; thus some of a retirement nest egg could be lost (e.g., the recession of 2000-2002).

Unexpected property disasters—accidents or natural disasters (tornadoes, floods, storms, blizzards, etc.) could destroy important physical assets. For example, many people who retired to the gulf coast experienced significant losses when Hurricanes Katrina and Rita blew through in 2005. They had to use a portion of their retirement savings to rebuild and replace the property they lost.

Income tax-free life insurance can reinforce a spouse's/partner's financial security and bolster her financial position. For example, Joe and Sue Smith retired in 1995. They had plenty of money until the recession of 2000 resulted in a 15 percent reduction in their retirement nest egg. Then Joe got cancer in 2004 and they had $95,000 in uninsured medical expenses. Joe died the next year. Fortunately, Joe had purchased a $150,000 policy on himself when they retired in 1995. The $150,000 in income tax-free death benefits will increase Sue's financial security. Best of all, the policy gave them both a good deal of peace of mind during Joe's ordeal.

2. Provide An Efficient, Flexible Alternative To Bequests. Many people have provisions in their wills to pay a lump sum of money to family members, friends or nonprofit organizations (e.g., colleges, religious organizations, social causes, etc.). These are called "bequests" and are part of many estate plans. Boomers who want to make sure their bequests are paid must refrain from consuming all of their retirement nest egg. A boomer who wants to pay $150,000 in bequests must have at least $150,000 unspent at death before the bequests can be paid. Consequently, this sum should be off limits to their retirement spending.

A life insurance policy can be a flexible and attractive alternative to a bequest. A boomer with a total of $150,000 of bequests in his will could instead purchase a $150,000 life insurance policy and name different beneficiaries to receive portions of the death benefit. A life insurance policy eliminates the need to keep a "reserve" for the bequests, because the life insurance death benefits will pay them. As long as there are funds to pay the premiums and the policy is in force, the boomer doesn't have to keep the $150,000 "reserve." He can feel free to spend all other assets during retirement. Because life insurance death benefits almost always exceed the total premiums paid, the bequests will be paid at a discount. The policy leverages the premiums into larger income tax-free death benefits.

Suppose Joe Smith wants to pass on $25,000 to his best friend, $50,000 to his church and $75,000 to his alma mater at his death. He can purchase a $150,000 policy with a $5,000 premium instead of adding a bequest provision to his will. If he lives for 20 years, he will have been able to pass on the $150,000 at the cost of $100,000 in premiums.

If Joe's financial situation changes or if he changes his mind about who should benefit from the policy or how much they should receive, he merely files a new beneficiary form with the insurance company. He doesn't have to revise his will. If times get tough, Joe can surrender the policy and spend the cash surrender value. Thus, life insurance can be a flexible and economically efficient way to distribute bequests. (This hypothetical example is for illustrative purposes only and should not be deemed a representation of past or future results. This example does not represent any specific product.)

3. Replace Income Taxes Paid On IRA Distributions. Many boomers are accumulating large percentages of their retirement savings in IRAs or other tax-qualified accounts. Contributions are made with pretax dollars and the account earnings grow income tax-deferred. Many boomers excitedly watch their qualified account balances increase in value over the years. Unfortunately, they often forget that nearly every dollar distributed from the account will be subjected to income taxes. As a result, the account balance on their monthly statement isn't entirely theirs to spend. Taxes will be due; they can spend only what's left after they've paid their federal and state income taxes. Depending on their marginal income tax bracket, between 15 and 40 percent of their account balances may be lost to income taxes.

Life insurance can help recover these income taxes. Policy death benefits can be paid to a surviving spouse or other family members to replace the income taxes they've paid. Premiums can be paid by using part of the distribution left over after income taxes.

Suppose Joe Smith has an IRA that he will use for retirement income. After retiring he begins taking annual distributions; his combined federal and state marginal income tax rate is 33 1/3%. During his lifetime Joe takes distributions totaling $600,000. Joe lost $200,000 of his distributions to income taxes. He would like to replace the $200,000 for his spouse and family and is willing to use part of his net after-tax IRA distribution to do so. He can use this money to purchase a $200,000 life insurance policy that will pay $200,000 income tax-free to his spouse and children.

4. Create Funds To Convert A Traditional IRA Into A Roth IRA. Some boomers will not need all the funds in their IRAs for retirement income. Their spouses and children will inherit the remaining balance as beneficiaries. Which do you think these beneficiaries would rather inherit: a $500,000 traditional IRA or a $500,000 Roth IRA? Most will prefer a Roth IRA because all distributions from inherited Roth IRAs are income tax-free. As a result, the Roth IRA will distribute more after-tax value than a traditional IRA.

Federal tax law allows every owner to convert all or part of a traditional IRA to a Roth IRA. All that is required is that the account owner has a modified adjusted gross income (MAGI) of less than $100,000 in the year the conversion takes place. (Under a new tax provision enacted in 2006, the $100,000 MAGI limit is waived in 2010 and 2011.) Surprisingly, even though most clients know how valuable a Roth IRA can be, very few have converted their traditional IRAs to Roth IRAs. Why? They don't want to pay the income taxes triggered by the conversion.

For the portion of their traditional IRAs they don't expect to use, boomers may be able to help their families get the benefits of a Roth IRA without converting it themselves. When a boomer dies and is survived by a spouse who is the IRA beneficiary, the spouse may roll the account over into his own name and then convert it to a Roth IRA. Life insurance on the boomer's life can provide funds for the spouse to pay the income taxes. As the policy beneficiary, the spouse can receive the death benefits and then use them to pay the income taxes due on the conversion. The spouse will then be the owner of a Roth IRA and have the freedom to withdraw as much or as little of it as he wishes.

If the spouse names the children as the Roth IRA beneficiaries, the Roth IRA balance remaining at the spouse's death will be paid income tax-free to them as well. Because the life insurance death benefits will exceed the premiums paid into the policy, the death benefits help pay the income taxes at a discount.

Suppose Joe Smith doesn't expect to use his $600,000 IRA during his lifetime. He has named his spouse Sue the IRA beneficiary. Joe can purchase a $200,000 life insurance policy on his life. At his death the $200,000 death benefit is paid to Sue. She can roll Joe's IRA over into her own name and convert it to a Roth IRA. Sue can use the policy death benefits to pay the income taxes on the conversion.

5. Increase The Legacy A Traditional IRA Can Pass On. Some boomers will have traditional IRAs or other tax-qualified accounts that they don't intend to use. As part of their estate plans they may want their children to inherit the account. They think the children will have the entire balance of the account to spend. Unfortunately, they'll be wrong. Because distributions from the IRA will be fully taxable to the children, they will be able to spend only what's left after the income taxes have been paid.

Income taxes can take a big chunk out of the spendable value of a traditional IRA. Suppose Joe Smith won't need his $600,000 traditional IRA while he's alive and he's named his only child John as the beneficiary. If John is in a 25 percent income tax bracket, he will have to pay $150,000 in income taxes when the IRA is distributed. Only $450,000 will be available for him to spend. If Joe's estate is subject to estate taxes, the total tax bite will be even bigger and John may have even less remaining after taxes.

If Joe wants his son to have the full $600,000 or even more to spend, life insurance can help. Joe can purchase a $600,000 policy on himself and name John the beneficiary. After age 59 $^{1}/_{2}$ Joe can take taxable distributions from his IRA without penalty and use the net after-tax distributions to pay the premiums. At Joe's death John will receive both the $600,000 death benefit and the remaining balance in Joe's IRA.

Depending on Joe's age, health and financial status, he may be able to purchase $800,000 or more of life insurance coverage. By "recycling" lifetime distributions from an IRA he doesn't need into life insurance, Joe can increase the financial legacy he passes along to his son. If he chooses, he can take distributions of his entire IRA and recycle its net after-tax value into life insurance premiums. Life insurance gives him the ability to expand/leverage all or part of his traditional IRA into a larger inheritance for those he loves.

6. Leave Just The Right Inheritance. Many boomers want to leave their children and grandchildren an inheritance but believe that if that inheritance is too large, it may "spoil" them and make them lazy. On the other hand, they don't want to leave an inheritance that is too small, either. The problem is to decide how much is "just right" and then manage the estate plan so just this amount is passed on at death. Unfortunately, this balancing act is very difficult and it can put a great strain on boomers using it.

Life insurance can solve the problem of leaving just the right inheritance. All a boomer needs to do is purchase a policy with a face amount equal to the total inheritance to be passed on to the children and grandchildren. Each child or grandchild is named a beneficiary of the amount the boomer wants him to receive. If the recipient is too young to efficiently manage the money, a trust can be created to manage it for them. At the insured boomer's death, each child/grandchild receives his inheritance. It is paid quickly and in cash that is free from income taxes. The remainder of the estate can be given to charity or it can be added to the cash inheritance the children received from the life insurance policy.

Suppose Joe and Sue Smith want to leave an inheritance of $500,000 to each of their four children. They can purchase a $2 million second-to-die life insurance policy and name each child a 25 percent beneficiary. As long as the policy stays in force, they can feel free to spend their other assets any way they desire. They don't have to manage their assets to leave an inheritance for their children; the life insurance policy will do that for them. Their wills can leave whatever remains to the charitable organizations of their choice. A child who wants a specific asset (e.g., the house or cabin) can use his share of the death benefits to purchase it from the estate.

7. Prevent Family Conflicts. A boomer's estate plan may accidentally create conflicts and bad feelings in the family after his death. Life insurance can provide additional dollars to reduce or avoid these potential conflicts. These are two common situations with serious potential for family conflict:

Second marriages—When a parent remarries, there is great potential for conflict between the new spouse and the children of the first marriage. The new spouse and children have different financial interests. After the parent's death, the new spouse needs financial security, but the children want their inheritance. If they have to wait until the new spouse dies, animosity and ill will may develop. This is especially true if the new spouse is relatively young and has a long life expectancy.

Life insurance on the parent may provide the financial security the new spouse needs and allow the children to receive their inheritance immediately. As a result, conflict between the spouse and children can be avoided or at least minimized.

Children treated unequally—Children often assume they will all be treated equally in their parents' estate plans. They may expect the assets to be divided up and distributed in equal parts. But sometimes it may not make sense to divide a house, a business or a parcel of land into equal shares. From the parents' perspective the nature of the assets or the children's personal situations may make equal division unwise or impossible.

The only way to treat children equally when assets can't be divided into equal shares is to use cash to make up the difference. Unfortunately, most boomers don't have large amounts of cash. Life insurance death benefits may create the additional cash needed to make sure each child receives equal value from the estate even if the assets they actually receive are different.

Boomers love their families. The prospect of bad feelings and animosity between family members is troubling, especially if it is the estate plan that triggers the conflict. No one wants their estate plan to be the spark that starts a family feud. Life insurance death benefits can add flexibility to an estate plan so that everyone is treated fairly.

The Magnificent Seven

These seven strategies will help you show boomers why they want life insurance death benefits to preserve their retirement assets:

Reinforce A Spouse's/Partner's Financial Security

Provide An Efficient, Flexible Alternative To Bequets

Replace Income Taxes Paid On Retirement Account Distributions

Create Funds To Convert A Traditional IRA Into A Roth IRA

Increase The Legacy An IRA Can Pass On

Leave Just The Right Inheritance

Prevent Family Conflicts

Selling More By Addition

Each of these seven strategies is a strong sales opportunity by itself. Any of them could motivate a boomer to purchase life insurance. But as compelling as each strategy is individually, they are even stronger when presented as a group. Tied together, these strategies complement each other to maximize your sales opportunity. When considered together, these strategies have a synergy that can increase sales because many boomers will be able to identify with two, three or even more of the strategies.

For example, you are likely to find many boomers who want to reinforce their spouse's/partner's financial security (#1), have specific bequests in their wills (#2), want to recover the income taxes that deplete the spendable value of their IRA accounts (#3) and want to prevent conflicts between their second spouse and their children from their first marriage (#7). You can combine several of these strategies together to determine the appropriate amount of life insurance to meet the individual client's overall needs.

In discussing the transition to retirement, boomers *must understand* that they are leaving behind an old set of financial challenges and taking on new ones. Once they understand this, they can let go of their old view that life insurance was solely designed to be used as an income replacement tool for their families. They can be open to new ways in which life insurance may help preserve their assets and potentially increase what they can pass on to their families when they die. Your sales opportunity can change from "which one" of these ideas will make sense to "how many." The sales opportunity is *cumulative*.

The summary sheet can help you stay on track so you explain all the strategies to each particular client and maximize the life insurance death benefit each client decides to buy.

Many boomers think that since they are retired, they no longer need life insurance. They can let go of this belief when they understand that retirement is a different stage of financial life that brings different goals and priorities. Life insurance can be very useful in preserving their retirement assets and meeting their wealth transfer goals.

Each of the seven strategies discussed in this article uses life insurance to enhance retirement planning. When presented as a group, they can work together to significantly increase the amount of life insurance sold. Consider using as many of these strategies as applicable when you meet with baby boomer clients who are retired or planning for retirement.

Neither ING nor its affiliated companies or representatives offer legal or tax advice. Individuals should consult with their tax and legal advisors regarding their individual situation.