Helping Young Adults Understand Insurance

Insurance should be part of everyone's plan – and it should evolve too

Young adults starting out in life, especially newlyweds, need insurance. But what kind? As a start, a good term life policy likely is a smart move. Other types of insurance may not be. And as they age, what other varieties of coverage make sense? A good deal of misunderstanding surrounds insurance protection planning.

Consider a couple, basking in the glow of their recent and beautiful wedding. For them, death is an abstraction that seems a remote possibility. But a life insurance agent, a friend of the groom, suggests that as a newly married man he consider life insurance – namely a $200,000 whole life policy. Here's why that is probably an unwise strategy.

Two Basic Forms of Life Insurance

Term insurance is pure mortality coverage, paying off if the insured dies within a specified term, usually 10 to 30 years. It has no cash value element, where extra premium is invested and functions as a savings account for the policyholder.

Then there is mortality insurance combined with a cash value element, often referred to by agents as permanent insurance and which may be in force for life. This type of coverage comes in various forms. With whole life, the insurer pays an annual dividend, based on at least a guaranteed minimum amount to build cash values. With universal life, the insurer pays interest at least a minimum guaranteed amount.

Variable universal life builds value based on a basket of separate accounts similar to mutual funds while offering premium flexibility. Obviously if a policy combines cash value with a death benefit, premiums generally are higher– and considerably higher at younger policyholder ages – than one would see on a pure term life policy.

Different types of contracts have uses relative to estate and charitable giving objectives, so one cannot make a blanket statement as to what kind of contract is best. For our newlyweds, 30-year term insurance might be the preferred solution.

Think About What Insurance Does

The primary purpose of life insurance is to protect someone from the economic implications of your death. Of our couple, both worked. What if he died and she was pregnant, or they already had one or more children? As a widow, perhaps with children, what would the loss of his salary mean to her economic security?

Conversely, if she died and he had to raise children alone, what would the loss of her income mean to the family? A sum of $200,000 invested at 4% net of taxes produces $8,000 annually, $667 in monthly income. Is that enough? Hardly.

Suppose he or she made $100,000 yearly. At 4%, you need $2.5 million in face amount to generate

$100,000 per year. For each $10,000 of annual income replacement needed, at 4% a face amount of $250,000 is required.

In the effort to sell whole life or other types of cash-value-building life policies, agents might suggest assembling a life insurance estate over time. That's fine, if you live long enough. But what if a breadwinner dies too soon?

One criticism of term insurance is that it is cheaper because people outlive it and never collect. True. But if you live to age 65, for example, and diligently invest, building cash value and financial independence in retirement plans and other investments, what's wrong with that?

If you want insurance to continue past 65 or so, a contract that pays off no matter when you die is a valuable part of estate planning. That's what some variation of cash-value-building insurance is for. What if most of your estate is a large non-liquid asset, such as a farm or closely held business? That means you or your heirs can't turn it into cash quickly.

Upon your death, an insurance payout meets that need. You may wish to provide for estate liquidity using second-to-die insurance (covering a couple, with the benefit awarded only after the surviving partner dies), also known as last survivor life. These are efficient vehicles for trust funds, especially special needs trusts for impaired children or adults, to provide for charitable gifts, or to pay estate taxes.

What about accidental death and dismemberment policies? Every time a major plane crash occurs, people think about such coverage. But of the 2.4 million deaths in the U.S., only 120,859, or 4.9%, resulted from accidents of all types. AD&D is cheap because of the low odds of dying from an unintentional injury. Do not use AD&D to cover basic life insurance needs.

Insurance Should Be Part of Your Plan

In holistic financial planning, look at all needs for insurance. Do you carry umbrella liability coverage on your car, boat, private aircraft or home? This protects you from aggressive lawsuits if someone is injured while aboard or inside one of your possessions. Many people miss that one.

As a breadwinner, do you have disability insurance from your employer? If so, and you are a higher earner, you may need to supplement a work policy with personal disability coverage. If you are self-employed, is disability covered?

If you are an entrepreneur with partners, are buy-sell agreements funded and insured? With these pacts, you commit to letting your business partners buy out your interest upon your death. The insurance on your life allows them to afford it.

As you get into your fifties, consider long-term care coverage. This covers you when you can't take care of yourself, and need a caregiver to come to your home or you must live in a nursing home.

Newlyweds in a state of bliss often are confounded by "what if" questions. At the altar, they made pledges to each other.

Regarding financial security, across-the-board insurance planning is fundamental to promises made.