



Life Insurance 101

47

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315

Introduction

When we are young and healthy, many of us believe that we do not need life insurance. We may assume that it is too expensive or too complicated. *This is a mistake.* Life insurance does not need to be complicated, and it is cheapest when you are young and healthy.

Why do we buy insurance? Because life and death happen and because you need to protect yourself and your family. We have all heard of someone passing away unexpectedly. Life insurance provides financial protection (tax free) for final expenses, living expenses for dependents, mortgage payments, educational costs, childcare costs, retirement planning, and debt protection.

Permanent vs. Term

There are two types of life insurance: permanent and term. If you are a young physician, term life insurance is most likely all you need. Permanent insurance makes sense for a small subset of younger people.

Permanent life insurance is an umbrella term that encompasses whole life, universal life, indexed universal life, and variable universal life insurance. Simply put, whole life insurance has a guaranteed premium and death benefit. Cash value builds over time that you may borrow against, withdraw, or invest. There may be opportunities for dividend payments. Universal life insurance has more flexibility in rates and benefits; you can change how much you pay and your death benefit amount. Indexed life insurance interest is tied to the financial markets. Variable life insurance combines the flexibility of universal insurance with the performance of investment accounts. Permanent life insurance is expensive, and there are penalties for canceling policies early.

Term life insurance gives a death benefit for a specified period, is the lowest cost life insurance available, but does not build cash value. Some carriers will allow you the opportunity to convert to a permanent product before the end of the term. Your financial burden is at its highest while raising children and preparing them to leave your house. It is during this time that you need the most coverage.

There is no penalty for canceling a term policy. In this chapter, I will be focusing on term life insurance. At the end of the chapter, I will discuss when I believe permanent life insurance makes sense.

Case Study

A pediatrician (Dr. B) was married with two young children. He and his wife had just received devastating news – she had breast cancer. While obtaining life insurance had always been on their to-do list, they had never actually purchased coverage. Dr. B panicked. He realized that his wife would not be eligible for coverage for quite some time, if at all. She had life insurance through her employer but that insurance was very small. Dr. B was understandably eager to obtain proper coverage but didn't know where to start.

Group vs. Individual

I often hear, “I have coverage through my employer, do I really need a separate policy?”

While most employers will offer some life insurance benefits, it is often a small policy that does not cover 100% of your needs. Group life insurance policies have varying tax consequences. And, if you leave your employer, the policy may not be portable.

An individual life insurance policy's death benefit is a tax-free benefit. It is owned by the individual and, therefore, completely portable. It is not dependent on employment status.

Dr. B was concerned that his wife would have to leave her job at some point during treatment. He found out that his employer policy was only two times his base salary. That amount would not be enough for his wife and children if he passed unexpectedly.

When Should I Get Life Insurance

If you were to die today, would those you support be able to take care of themselves? If you answered yes, you probably do not need life insurance. If however you have someone who depends

on your income, you need life insurance. While that is a good basic rule, there are always exceptions, particularly when it comes to men and women.



Men should obtain life insurance when they have a dependent. Women should secure life insurance before their first pregnancy. Issues in pregnancy, such as gestational diabetes and preeclampsia, greatly increase the cost of coverage. Women have told me that they did not think they could obtain coverage while pregnant. That is false. Women can obtain coverage while pregnant, and the earlier they do so, the better. Additionally, not getting routine screening, such as Pap smears and mammograms, can significantly affect the cost of life insurance for women.

How Much Do I Need and for How Long

There are several complicated calculations that take into account everything from potential inheritances to the average cost of a funeral to show apparent benefit needs. But, I like to keep things simple. For most people, I have found that 10× income or \$1 M a child plus mortgages and other debt that would remain past a death generally provides a good range of coverage.

Remember, your largest financial burden is raising a family and getting your children out of the house and educated. You will need more coverage while your children are at home. Once they are out of the house, your financial burden often lessens.

When determining the length of terms you need, think about why you are purchasing the policy. Most people will talk in 10-year increments – 10-year, 20-year, 30-year products. Some, but not as many carriers will offer 5-year plans. Your goal should be to ensure that your children will be raised and educated in the way you had hoped and planned.

As you build assets, and as your children leave home, you will need less coverage. Often, people will ladder policies (multiple policies with different terms) to have the highest coverage for the appropriate amount of time at the lowest cost.

In the case of Dr. B, his children were 1 and 6. We discussed both a 20-year term and a 30-year term. In 20 years, both of his children would presumably be out of the house; however, their education may not be completed. Once the children are out of the house and the majority of childrearing has occurred, the financial burden for Dr. B will be lessened. The 30-year product would provide for his children's education and any other early adulthood help that Dr. B and his wife wanted for their children.

How Much Does It Cost/How Do I Choose a Company

Whereas disability insurance is more expensive for women, life insurance is more costly for men. Men tend to die younger, and more successfully by their own hands. Permanent life insurance can be five to ten times as expensive as term life insurance.

Rates are based on many factors: gender, age, health status, habits, occupation, family history, and more. The younger you are, the cheaper the policy. The older you become, the more morbid you become, the more expensive the insurance. You should not wait. You'll want to find a company that has a strong financial history, a good range of products, good ratings (there are many scales), and good client services.

There are available riders that can increase the cost of the policy, as well. Different riders are available for term and permanent products.

When Does Permanent Make Sense

There are situations where permanent life insurance makes good sense.

Some term policies will allow you the opportunity to convert to a permanent product at the health class you received upon purchase. This is ideal if you have had a significant health change between your original purchase and the end of the term. There are many reasons that you would like to continue with life insurance after the term product. You might have a second mortgage; you would like to help your children with graduate school; or you just want to build an estate. If something happens to your health, you are still insurable. You would, however, have to switch to a permanent product.

If your estate would be subject to estate taxes, a permanent policy could be used to offset those taxes. The IRS announced that for 2020, the estate tax and gift tax exemption is \$11.58 M per individual.

Another situation where a permanent product makes sense is in the case of having a lifelong dependent, such as a child with special needs. Permanent life insurance can fund a special needs trust to provide care for your child after you are gone.

What Happened to Dr. B

We were able to secure quality convertible term policies. Dr. B and his wife can now focus on her treatment and recovery.