The value of life insurance as a generational wealth-transfer tool.

By R. Matthew Pate, JD, LLM

Many people are familiar with the rags-to-riches-to-rags wealth phenomenon. The first generation builds it, the second manages it, and the third squanders it. Fear of this phenomenon motivates many families to develop a generational wealth plan that maximizes incentives for productivity and for the prudent stewardship of wealth. While today's wealthy seniors are likely to die with far more assets than they'll ever need, what they pass on may be a necessary source of income for their children and grandchildren, especially considering the ever-increasing costs of fundamental expenses like higher education, homeownership, and healthcare. In addition, increased spending, decreased saving, and greater longevity, may mean that wealth remains a generation or two later.

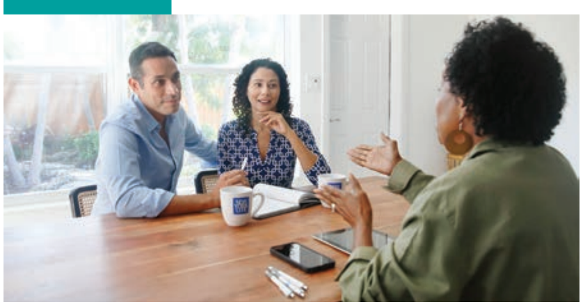
Enter life insurance.

Well-known as a tool for financial security and future income replacement, life insurance is often perceived as unnecessary once one's children are grown. In fact, growing families frequently use term insurance under the assumption that they need to ensure that they won't suffer a catastrophic loss of income if a breadwinner die. However, a wide variety of customizable permanent life insurance products are often preferred because they provide both income replacement during one's working years (through cash value that accumulates over time) and a means for guaranteeing long-term family wealth (through lifetime coverage as long as premiums continue to be paid). Using permanent life insurance for generational wealth planning has three primary benefits: leverage, guarantees, and simplicity.

Benefit 1: Leverage.

With life insurance, you pay premiums in exchange for what will likely be a larger payout in the event of your death. This leverage of premium dollars is intended to provide a "positive return" on outlays for the benefit of your designated beneficiaries. The expected performance of a life insurance policy should be viewed in light of desired family wealth goals, and it can be a complement to other investments in a financial portfolio. Fees, taxes, and risks associated with any financial products should, of course, always be considered.

EXAMPLE:



Brian and Sofia have saved $2 million to provide them with income in retirement. They can live comfortably off their savings, but they are concerned about preserving a meaningful portion of their nest egg to provide for the education of their many grandchildren (a sum that could approach $1 million). If they include permanent life insurance in their budget, they can ensure that money will be available to help pay for their grandchildren's education and other family needs after they've died. This may even allow them to spend more freely in retirement and enjoy their golden years as they desire.

Benefit 2: Guarantees.

Guarantees are key benefits of permanent life insurance. Depending on the type of insurance, guaranteed annual premiums and guaranteed death benefits can provide certainty regarding the availability and cost of coverage. And while life insurance is largely viewed as a commodity, guarantees are backed by the financial strength of the issuing carrier. For this reason, it's important to consider reputation and financial stability when choosing a life insurance provider.

EXAMPLE:

Alessandro and Melissa have decided that purchasing a $500,000 life insurance policy will ensure that they can provide for their grandchildren's education. Their main goal is finding a solution in which the death benefit will be guaranteed, premiums will never change, and the premiums can be paid in full. A whole life policy from a well-known and highly stable insurance company may make the most sense in addition to the guaranteed return on premiums, there is also the potential of accruing dividends, which further increase the return on premiums.

Benefit 3: Simplicity.

Life insurance can offer tremendous simplicity in an otherwise complex and often confusing planning environment , which is impacted by tax, probate, and creditor risks.

Tax benefits

The beneficiary generally receives a life insurance death benefit free of any income taxes. Contrast this with the income tax on accumulated savings that would otherwise be left to heirs. While life insurance proceeds are included in a taxable estate, the current federal estate tax exemptions ($12.92 million per person in 2023) effectively eliminate the vast majority of people from federal estate taxation. Note that some states impose a state level estate tax at lower thresholds, but trust arrangements can be employed to address this issue.

Probate avoidance

Life insurance proceeds are paid directly to the designated beneficiary of the policy, avoiding probate delays and additional legal expenses. Funds are generally paid after a simple claim form is completed and the death certificate is presented. Beneficiaries can be easily changed to reflect the insured's changing wishes. Contrast this with the difficulty in updating and properly executing a codicil to a will or other estate-planning document.

Asset protection

Depending on state exemption laws, the death benefit received from an insurance policy may be exempt from potential creditor claims against the policyholder, and sometimes outstanding claims against the beneficiaries as well. Where enhanced protection is desired for long-term wealth management, a trust established during one's life or under one's will can likewise be named as a beneficiary of a policy.

EXAMPLE:

John and Carrie settle on a $500,000 whole life product they can comfortably afford. They designate their three children as equal beneficiaries of the policy, with the direction to them that funds are to be used for educational costs as needed. They like the idea that they can modify the beneficiary designation in the future and that all proceeds will be paid free of income taxes and be protected from their potential creditors, depending on their state of residence. They may consider using a trust in the future, in consultation with their estate planning attorney and depending on whether tax laws change.

On a final note.

Life insurance has attributes that make it a uniquely effective way to create wealth for the next generation. More fundamentally, though, permanent life insurance is a purchase one makes because, even if the future cannot be known, you can ensure that family legacy goals are insulated from risks such as taxes, market fluctuations, and changes in personal health. By providing a very predicable amount in an otherwise unpredictable world, individuals have more freedom to enjoy their wealth, liberated from concerns about the adequacy of their support for their loved ones.

About the author.

Matt Pate is the department head of Nautilus Plus at the Nautilus Group of the New York Life Insurance Company. It serves the complex planning needs of New York Life's top select agents and their high-net-worth clients. Matt has extensive experience in sophisticated estate planning, business succession, closely held businesses, life insurance, asset protection, and charitable planning techniques. He has authored numerous legislative publications and newsletters, including New York Life's *Eye on Washington*. Matt received his undergraduate degree from Georgetown University, then obtained his JD from the University of Texas School of Law and his LLM from SMU.

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