

Taking A Second Look At Survivorship Life Insurance

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Due to changes in estate tax laws and the downturn in the economy, *now* is a great time to review your clients' life insurance needs. Prior solutions may no longer be adequate or necessary. A re-determination of your clients' needs for life insurance and a thorough evaluation of existing planning are in the best interest of both you and your clients.

Let's evaluate survivorship insurance, which is also known as second-to-die life insurance, and why it may not always be the best solution for your client. As you review your clients' insurance needs, it might become apparent that insuring the first person most likely to die is a better strategy.

Survivorship life insurance has traditionally been sold as the most cost effective life insurance for estate planning liquidity needs for married couples and their families. The reason that survivorship life insurance is less expensive than insurance on a single life is that the life expectancy of the second of two people to die is greater than that of any single individual.

In a case study we recently performed, the proposed insureds were a male age 64 and a female age 63. The life expectancy of the male was 16 years, the female 21 years, and jointly 25 years. Given the time value of money and the number of years of premium payments, it is easy to understand why premiums on survivorship



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life insurance are smaller. The question is twofold: (1) Does survivorship life insurance adequately meet the needs of the family today? (2) Is survivorship life insurance really the most economical way to buy life insurance?

Reassessing the need

As a result of a combination of changes in the estate tax unified credit and the ongoing stock market and financial industry debacle, many families no longer need life insurance to meet estate tax liquidity needs. Families have seen the value of their estates drop below \$7 million, which is the current estate tax threshold for married couples.

Accordingly, many families must re-evaluate their life insurance needs. We recently encountered numerous instances where the need for insurance changed from providing estate tax liquidity to rebuilding the estate and providing security for the surviving spouse. In these circumstances, having insurance on both spouses individually will serve the family's needs better than survivorship life.

In larger estates, where liquidity is still needed to pay the estate tax, individual life may still best serve the family's needs even though the initial cost of the premium may be greater than that of survivorship insurance. It is not difficult to foresee an instance where there is an early death and certain assets of the decedent are expected to rapidly appreciate. The appreciation between first death and second death could be very large.

Electing to have these assets taxed at the first death could save the family millions of dollars in estate taxes. Having life insurance on the first to die will provide the liquidity to the estate to pay the tax due at the first death. Clearly, the ultimate estate tax savings will be far greater than the increase in insurance cost on a single life policy versus a survivorship policy.

The true cost of insurance

An often overlooked fact is that survivorship life insurance guarantees the longest time period a family must continue to pay premiums before a death benefit is received. Using the time value of money and current life expectancy tables, it becomes apparent that insurance proceeds received on the first person expected to die policy, if reinvested over the joint life expectancy at a given rate of return, will require significantly less death benefits to provide the same ultimate return to the family at the projected second death as a survivorship policy.

In the case illustrated, \$1,087,867 of death benefits received at the first death invested over 9 years at 7% produced \$2,000,000 at the joint life expectancy date. The premium cost to insure the first life for \$1,087,867 is \$25,216. The premium cost of second to die insurance for \$2,000,000 is \$29,712.

The total anticipated cost of insurance over the life expectancy of insuring the first to die is $\$25,216 \times 16 = \$403,456$. The total anticipated cost of the survivorship policy is $\$29,712 \times 25 = \$742,800$. In addition to the cost savings of \$339,344 realized by the

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family from buying insurance on the first to die, the family will have the benefit of having \$1,087,867 available upon the first death should other needs arise.

Another significant benefit is that the survivor will not be saddled with the obligation to continue premium payments for 9 additional years. We have been asked to remedy situations where the surviving spouse did not have the cash flow to pay the ongoing premiums after the husband's death.

Our solutions necessitated reducing the premium cost by changing the death benefit or the guaranteed period or other elements of the contract that greatly reduced its effectiveness and certainly did not accomplish the original objectives of the deceased. The emotional impact of death is severe enough without aggravating the situation with stress over shortage of funds to maintain life insurance on the survivor.

Therefore, it appears that the *true* cost of life insurance is both financial as well as emotional and that insurance on the first most likely to die may be far less expensive than life insurance on the second to die both financially and emotionally.

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