One Resource Group
13548 Zubrick Road
Roanoke, IN 46783
888-467-6755
Life_Sales@ORGCorp.com

Reviewing Levels of Life Insurance Coverage

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What is an insurance coverage review?

Periodic reassessment of insurance need

An insurance coverage review is a periodic reassessment of your insurance need. The main objectives are to confirm that the level of insurance coverage you have is still adequate, to alert you to shortages in coverage that can occur due to changes in your life, and to ensure that any cash value policies are performing as expected.

Why should you review your insurance coverage?

Avoid problem of insufficient coverage

An important reason to review your insurance coverage is to avoid a mistake of not having enough. Your insurance needs will change over time. The problem with insufficient coverage is that when you die, there may not be enough money to pay for your final expenses and any estate taxes and still have enough for the needs of your survivors. There are several ways your coverage could become insufficient (which we'll discuss shortly), but there's one easy way to monitor and correct the situation if it happens: reviewing your coverage.

Avoid excessive coverage

Another potential mistake with life insurance is having too much coverage. This is actually the least important mistake, but it could cost you money, especially if you are still paying premiums. If you periodically review your coverage and discover that you have more life insurance than you need now or for the future, you can correct the situation.

Monitor policy performance

If you have cash value life insurance, your policy was presented with an illustration--a hypothetical projection of the performance of the cash value based on certain assumptions. An insurance coverage review is a great way to check on the actual performance of your policy. Some types of policies could lapse as a result of poor performance of the cash value underlying investments. By periodically reviewing your coverage, you can take steps to prevent a policy lapse (such as reallocating your cash value investments).

When should you review your insurance coverage?

Occurrence of major life events

Any time you experience a major life event is an appropriate time to review your coverage. Major life events can include the following:

- Change in partnership/marital status--marriage, divorce, or widowhood
- Birth or adoption of a child (or even a grandchild)
- Deterioration in health--yours or your partner's
- Support of parent (care or financial)--yours or your partner's
- Purchase of a home--primary or second residence
- Career changes--promotion, layoff, business start-up or failure, pending or recent retirement, salary increase or decrease
- Educational milestones--children or grandchildren entering private school or college
- Change in assets and/or liabilities--debt level, refinancing, or property ownership
- Inheritance--received by you or your partner

Every three years or so (maybe even yearly)

It is a good idea to review your insurance coverage every three years or so, even if you haven't experienced a major life event or change in your lifestyle. The major consideration for this time frame is inflation. Economic conditions and the inflation rate could cause the value of your life insurance to diminish over time, and $200,000 a few years ago may not get you $200,000 worth of purchasing power today, not to mention in the future. If the inflation rate is different than the one used previously to calculate your insurance need, you could be losing buying power.

Tip: *Some planners recommend yearly checkups for your insurance coverage. This timetable can allow you to monitor and fine-tune your insurance coverage as part of your overall financial plan and budget for the year.*

How do you review your insurance coverage?

Recalculate insurance need and compare to existing levels

Just as your need for insurance was analyzed and calculated back when you bought your policy, the same procedure can be repeated to review your coverage. Methods of determining insurance need include the rules of thumb, income replacement, and estate preservation and liquidity methods. The newly calculated amount of insurance need should be compared to your existing amounts of coverage to determine any shortfall or excess.

Tip: *Your financial planner may contact you, suggesting a review. If not, don't be afraid to call and ask for a review.*

What are the options for correcting problems discovered in the review?

Buy more insurance

If your review indicates that you need more insurance, you may want to buy an additional policy for the amount of the difference. Think very carefully before canceling an existing policy and using any cash value to buy a larger one. There are several reasons why you may not want to take that approach. You may be subject to surrender charges, you'd be starting all over again with brand-new coverage, and you'd be paying policy fees and expenses again, as well as beginning a new contestability period . You could be taking a big reduction on your cash value balance that accumulated in your old policy. In addition, you are older, and premiums increase with age, so you might be paying higher premiums on the total of your coverage instead of just the new portion.

Tip: *If your present policy is a cash value policy, you may be allowed to increase your death benefit. This may require a medical exam but could be worth the inconvenience.*

Tip: *Insurance costs have decreased in recent years, so it is possible that even though you are older, you may be able to buy a less-expensive policy than was available in the past.*

Reduce death benefit on existing insurance

If your review indicates that you have too much insurance, you may be able to reduce the amount of your death benefit on the existing policy. You may even convert a policy on which premiums are still being paid to one that is paid up. Of course, this option is completely dependent upon the specific type(s) of insurance policy you have. Don't make any quick decisions, though. You may be just fine keeping your existing level of coverage, especially if your policy is already paid up.

Tip: *Talk to your insurance agent or financial planner before reducing your death benefit. You may discover your excess coverage is temporary or not large enough to warrant a decrease in coverage.*

Caution: *There could be tax consequences arising from a decrease in death benefit. Be careful.*

Cancel an existing policy

If your review shows that you have too much insurance, you might consider canceling a smaller policy (assuming, of course, that you have multiple policies). Think about this carefully, and talk to your financial planner and insurance agent first, because while this is an option, it doesn't necessarily mean you should do it.

Caution: *There can be tax consequences resulting from policy cancellations. Be careful.*

IMPORTANT DISCLOSURES

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