FINANCIAL PREPAREDNESS

"One of life's most painful moments comes when we must admit that we didn't do our homework, that we are not prepared." ~ Merlin Olsen

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Life Insurance

If you have dependents but have not yet become financially independent, there needs to be life insurance coverage on your life. A level term policy is the way to go as it is pure insurance and also the least expensive type of policy. Term life insurance is basically a commodity, so going with the lowest price is generally a good strategy as long as you buy it from an insurance company that is financially strong (check its ratings from several different rating agencies); this will be crucial in the years ahead if the bond market collapses as I suspect will happen.

The more dependents you have, the younger they are and the further away you are from financial independence, the more coverage you'll need. As time passes and your dependents get closer to adulthood and you get closer to financial independence, you generally need less and less coverage each year. So you may want to stack a couple of policies with different terms. For example, if you have a 3-year old child and you estimate you're 15 years away from financial independence, you could buy a $1 million term policy that has level premiums for 10 years (after which they increase each year if you decide to keep the policy) and a $1 million term policy that has level premiums for 15 years.

If you have any “incidents of ownership” in the policy (e.g., if you own the policy on your life, if you can access the cash value, change the beneficiaries, etc.), then the death benefit will be includable in your gross estate for federal estate tax purposes, which is no bueno. So either your spouse or an irrevocable life insurance trust (ILIT) should own the policy on your life. If a spouse owns a policy on your life, the death benefit will not be includable in *your* taxable estate, but unless your spouse has spent the money or given it away before her death, it will be includable (along with any appreciation of it that occurred between your deaths) in *her* gross estate for federal estate tax purposes.

An ILIT removes the death benefit (plus all of the appreciation that occurs in the trust *between* your deaths) from *both* of your estates, but still allows the beneficiaries of the ILIT the use and enjoyment of the money, according to the terms laid out by the grantor.

There are two ways to do this: (1) set up an ILIT for each of you and have the trustee of each ILIT apply for, pay for and own a new life insurance policy on your life, or (2) set up an ILIT for each of you and then gift some or all of your existing policies to the ILITs. The second method has two drawbacks. First, if you gift a policy that has a cash value, you have to be careful not to make a taxable gift (to qualify for the annual gift tax exclusion, it must be a gift of a present interest and the value must be less than $15,000 [for 2021] per donee per year). Second, if the grantor dies within three years of gifting a life insurance policy on his life to an ILIT, the death benefit will be includable in his gross estate for estate tax purposes and the ILIT will not have accomplished anything in terms of reducing his or her estate tax.

Just because a spouse is not employed, that does not necessarily mean that she does not need any life insurance coverage on her life. Unemployed spouses usually perform a variety of critical and valuable tasks such as child rearing (perhaps including home schooling), cooking, laundry, housekeeping and grocery shopping that would still need to be performed by one or more paid employees if the surviving spouse did not remarry. Life insurance coverage on an unemployed spouse gives the surviving spouse the option of not remarrying just to help make ends meet. Generally, the amount of coverage needed on the life of an unemployed spouse is much less than the amount needed on the family's breadwinner.

Life insurance has been a wonderful innovation of the free market and has saved many families from financial ruin. However, there is one huge caveat to keep in mind for the years ahead. A life insurance policy promises to pay a certain number of dollars, but there is no guarantee of how much those dollars will be worth when the death benefit is paid. I believe that the dollar is doomed (and sooner rather than later) because politicians always want to spend more money than they have. This has been happening since at least the time of ancient Rome, so it is nothing new and it's not going to change or stop.

Insurance companies invest the bulk of their portfolios in bonds, so if hyperinflation destroys the bond market as I expect it will, most insurance companies will probably go bankrupt, especially since virtually no one will want to buy insurance products that pay a fixed dollar amount at some point in the future. So life insurance may be able to provide some protection for up to several years, but I would not count on a death benefit that's

paid ten or 15 years from now being worth anything, so *caveat emptor*.

Insurance has been a wonderful product that allowed man to tame risk and avoid the financial consequences of unexpected calamities, but it requires sound money, and cannot survive in the long term in a system dominated by politicians and fiat currency.

What You Should Be Doing Now

I plan to cover the why and how of these in future issues (if I haven't already), but here are some actions I recommend you take (or at least start thinking about) now:

1. If you have dependents but haven't reached financial independence yet, start thinking of ways to mitigate the risk of premature death if life insurance either isn't worth anything or is not available. This could include (1) reducing your risk of premature death (e.g. by living a healthier lifestyle, getting an annual physical, driving less, etc.) and (2) setting aside wealth now in a form that can't be eroded by inflation (e.g. physical precious metals).

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I would love to hear from you! I thrive on feedback from readers. If you have any comments, suggestions, insight/wisdom, or you'd like to share a link to a great article, please email me.

Generally, I don't have time to answer questions about your specific situation, but if you have a general question that I think other readers also have, let me know and I will provide an answer in a future issue.

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