856-673-4045
GFaulkner@finsvcs.com
www.faulkner-financial.com

Consider Inflation When Assessing Your Insurance Coverage

By: Gwendolyn A. Faulkner

When Brenda and Jake Simpson purchased their life insurance policies 20 years ago, they thought they did things the right way. They assessed their insurance needs, taking into account their home mortgage, the projected college education costs of their children, and their living expenses. Well, that was then. . .this is now.

Recently, as they contemplated retirement, the Simpsons reevaluated their insurance needs and were surprised to discover their insurance coverage is inadequate. How could this be? The answer, in a word, is inflation.

Because inflation affects purchasing power, it may also affect life insurance needs. For couples like the Simpsons, inflation means that life insurance coverage that was adequate years ago may now be insufficient. With this in mind, consider three of the more common uses for life insurance proceeds that may be affected by inflation:

Paying Off Your Mortgage. Until recently, it seemed that many people who bought houses lived in them for their entire lives. Today, Americans are increasingly mobile. Changing job markets, along with dual incomes, have altered the dynamics of family finances. In many cases, a family or retired couple can now afford to pay a mortgage on a lot more "house" than at any time in the past. Does this trend minimize the reality of inflation and the rising costs of home ownership? Not at all. The fact is that escalating real estate prices have translated into larger mortgage loans. Therefore, if you have recently upgraded your home, you may need to consider increasing your life insurance so that you can adequately cover the cost of your mortgage in the event of your death.

Funding Future College Expenses. With many individuals retiring at younger ages, it may be common to be nearing or in retirement while you still have children waiting to attend college. If so, you are probably concerned about the rising costs of higher education. Compared to the previous year, the average annual cost of tuition, fees, room, and board for the 2007–08 academic year increased 5.9% at private and public four-year colleges (The College Board, 2008). To be prepared, be sure to factor inflation into your college savings strategies. In addition, have a contingency plan in the form of adequate life insurance to help provide protection in the event of an untimely death. Review your plan periodically, and consider increasing your coverage to reflect the anticipated future cost of higher education.

Maintaining Your Standard of Living. Over time, the costs associated with the normal expenses of everyday life, as well as the special pleasures most people look forward to in retirement—traveling, visiting children and grandchildren, and engaging in favorite hobbies and leisure time activities—are affected by inflation. As a result, the lifestyle you hope to enjoy in retirement could be affected too. The cash value accumulation of a permanent life insurance policy can help supplement retirement income, though not without impacting the policy. Distributions under a policy (including cash dividends and partial/full surrenders) are not subject to taxation up to the amount paid into the policy(cost basis). If the policy is a Modified Endowment Contract,policy loans and/or distributions are taxable to the extent of gain and are subject to a 10% tax penalty. Access to cash values through borrowing or partial surrenders can reduce the policy's cash value and death benefit, can increase the chance the policy will lapse, and may result in a tax liability if the policy terminates before the death of the insured.

Future Projections

Determining current life insurance needs is one thing, but figuring out how much coverage you'll need in the future requires you to pay careful attention to inflation and how it can affect your lifestyle. Regular reviews of your insurance coverage can make a great deal of sense. Plan to set aside time at least once each year to help ensure your life insurance program is keeping up with inflation.