Expat Financial Advice: Eight Questions to Ask Before Buying Life Insurance

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Many expatriates require some form of life insurance, especially those with either family members or other financial obligations that could outlive them. However, sorting through the countless options to determine the best policy for your situation can be time-consuming, and calculating the correct amount of insurance to purchase can be tricky. Insurance is a complex product, and many people don't fully understand what they are buying or even if what they bought really meets their needs.

Unfortunately, relying on an insurance agent or broker to help sort through the options and hoping for the best may not produce the most favorable outcome. An insurance agent's loyalty is to the insurance company, not to you. While, in theory, a broker should represent your interests, in the offshore markets that distinction may not hold. You should be prepared to conduct some due diligence on your own.

To help with the due diligence, the next time you're in the market for a life insurance policy, run through the following list of questions. And if you have an existing policy, take it out and evaluate it using the questions below. You'll be in a better position to make an informed decision when it is time to purchase or renew a policy.

1. Do I need life insurance?

Not every expat needs life insurance, but many do. If you're single with no dependents, a child or young adult, or a nonworking spouse, or if you already have sufficient wealth to provide for your loved ones after you die, you may not need life insurance. But if someone depends on your income, then you will likely need life insurance. In families, this need can go beyond just breadwinners. In some cases, it may also make sense for a nonworking spouse to be insured to help the surviving spouse with the costs of day care and other services. Those with children from previous marriages and those with children and dependent parents face even greater insurance needs.

There are other good uses for life insurance such as:

- Providing liquidity and preserving the value of an estate for those subject to inheritance or death taxes
- Paying off debts, particularly those co-signed by family, friends, or business partners
- Providing charitable donations at death
- Constructing a buy-sell or business continuation agreement for a closely held company or partnership

One common use that rarely makes sense for most expats, though, is using life insurance as an investment vehicle. This is especially true given the excessive fees attached to offshore investment-linked insurance schemes. The numbers rarely add up, especially compared with the alternatives. If you're a U.S. citizen, you may also find that offshore investment-linked insurance schemes do not qualify for U.S. tax deferral benefits. Most expats will be better off using separate vehicles for insurance and investing.

2. Do I need life insurance permanently or for only a specific time period?

The next question to consider is whether you have a temporary or permanent need for life insurance. For many, the goal is to provide family members with protection against an untimely death until the kids are out of college, the house is paid off, and retirement has been funded. In this case, the need is temporary, and term insurance may be the best answer.

For needs of the following sort, you'll want to consider some form of permanent life insurance:

- Providing for a special needs child through adulthood
- Providing liquidity for an estate and for some estate planning strategies
- Liquidating a business interest
- Making charitable gifts
- Insuring a key employee

3. What are the options for term insurance?

Term insurance provides protection for a specific time period and is the least expensive way to purchase substantial coverage. This is because the insurance company knows it is unlikely it will have to pay out—less than 1% of all term policies pay a death benefit. Despite the low payout ratio, term insurance is not a waste of money. For a relatively small premium, you're hedging a low-probability, but potentially catastrophic, event.

Term insurance comes in several forms. Some of the most common are:

- **Annual renewable term:** The premium is paid for each year of coverage, but the policy is guaranteed to be renewable each year without proving insurability for a period typically ranging from 10 to 30 years. The premiums increase each year.
- **Level term insurance:** With guaranteed level premium term life insurance, the annual premium is guaranteed to be the same each year for a given period. Common terms are for 10, 15, 20, and 30 years.
- **Decreasing term insurance:** In this case, the premiums remain the same throughout the insured period while the death benefit declines. Typical uses are to insure the repayment of a mortgage.

There is no free lunch here. Regardless of how the premium payments are structured, all forms of term life insurance are based on the mortality risk of the insured and are actuarially equivalent for the same person, period covered, and death benefit.

Features you may want to check for include renewability and convertibility. A renewal option allows the insured to renew coverage once the initial insurance period has expired at a maximum guaranteed rate. This option may or may not be guaranteed and may require proving insurability again. The conversion option allows the insured to convert the term policy to a permanent policy without proof of continuing insurability.

4. What are the options for permanent insurance?

Unlike term insurance, permanent life insurance is a policy that you plan to keep for your entire life. The most common types of permanent insurance are:

- Whole life
- Universal life
- Variable life
- Variable universal life

The detailed distinctions between each type of policy are too complex to cover here, but regardless of the type, the premiums will be substantially higher than for term insurance. Since the insurance company will definitely have to pay out, permanent policies all have cash accumulation features designed to ensure that the policies are self-funding at the aggregate level. Cash builds up in the initial years as premium payments are in excess of the cost to insure the actual mortality risk.

Major differences between the policies relate to the variability of the death benefit, flexibility surrounding how the premium is paid, and how the cash values are invested. There are also a number of riders or options that can be attached to various policies. If you think you need a permanent life insurance policy, it may pay to sit down with an experienced advisor or insurance broker to ensure you are getting a policy that fits your needs.

5. How much insurance do I need?

Individuals and insurance brokers alike employ various rules of thumb for determining the amount of insurance coverage required, such as 6 to 10 times your annual income. Unfortunately, these simple estimates fail to capture the variation in insurance needs among expats of similar income levels. It is unlikely that a 45-year-old whose spouse works and who has no children and no significant debt will have the same needs as a 45-year-old who is married to a nonworking spouse and has three college-bound children, a mortgage, and a dependent parent.

A better way to determine the amount of needed insurance is to conduct a capital needs analysis. Two key questions that need to be answered are:

1. How much is needed for various purposes if the insured were to die today?
2. When is the income needed for each purpose?

The following is one way to help think about your insurance needs:

- **Estate settlement fund:** Estate taxes, debts, funeral expenses
- **Readjustment period income:** An adjustment period for families to deal with the loss and to scale down lifestyle needs
- **Child-rearing period income:** Net income needed to support the family while the children are still at home
- **Spouse retirement income:** Income needed to support the surviving spouse’s retirement
- **Mortgage redemption:** Funds needed to pay off a mortgage or other long-term debt
- **Education funding:** Provision for college funding
- **Special needs funding:** Liquidating a business interest, setting up a trust for children with disabilities, making charitable donations
- **Emergency funds:** An extra expense fund for unanticipated emergencies equal to three to six months of family expenses

For each category, you will need to estimate the required needs discounted back to today’s dollars. Once you’ve added up all the costs measured in today’s dollars, you can subtract your existing assets and future income streams such as salary from the surviving spouse that can be used to fund your future needs. The deficit between what you need to fund and the assets you currently have to meet those needs is what needs to be covered by insurance.

The calculations can be complex to do by hand, but there are some generic life insurance needs calculators on the web. You may also want to engage your financial advisor or an insurance broker who is truly working in your best interest.

6. Should I get life insurance through my employer or purchase an individual policy?

Many expats get their life insurance through their employers via a group policy. This may be sufficient for some, but a group policy may not be tailored enough for all. Additionally, it is important to understand what happens to coverage when you are no longer employed with the firm providing the group coverage. Can the group coverage be converted to an individual policy without proving insurability if you leave the company? At what cost?

Another way may be to consider purchasing an individual policy. This will be more expensive than a group policy, but it can be tailored to your situation and removes the concern of losing coverage when changing employers. You may also be able to negotiate with your employer to compensate you for the premium payments as part of your employment package.

In today's world of decreased job security, not having your insurance benefits tied to your employer is something to think about.

7. Who should own the policy?

For a life insurance policy, the owner, the insured, and the beneficiary can all be different people. It is common, though, for one spouse (say the husband) to be the owner and the insured party, and the other spouse (in this case, the wife) the beneficiary. In many cases, this is fine, but sometimes it may make sense for the owner of the policy to be someone other than the insured.

For example, life insurance benefits are generally not subject to income taxes in most countries, but if owned by the deceased and depending on the nationalities involved and the size of the estate, they may be subject to estate or inheritance taxes. This may not matter if the policy's beneficiary is a spouse of the same nationality as the insured deceased, since an unlimited marital deduction may apply in calculating the size of the taxable estate. But if the beneficiary is not a spouse or is not the same nationality as the insured deceased, the policy's payout may be subject to estate tax. While the U.S. federal estate tax exemption has been raised to $5 million, other countries and regions such as the U.K. have substantially lower thresholds where estate tax may be owed. In these cases, one option that may make sense is if the beneficiary owns the policy on the insured's life, rather than the insured. That way, the death benefit is kept out of the estate of the deceased altogether.

8. How secure is the insurance company?

Before choosing an insurance policy, check out the financial strength of the insurer. The policy is only as good as the insurance company's ability to pay. Some of the better-known insurance rating companies are A.M. Best, Standard & Poor's, Moody's Investor Service, Fitch Ratings, and Weiss Ratings. Choose an insurance company that gets top marks from several of these rating agencies.

In Summary

Insurance is a complex subject and, given its importance to the security of many expat families, one that deserves considerable attention. The questions above encompass just the basics, but they will go a long way to helping you choose a suitable policy and the right amount of coverage—or at least help you start to ask the right questions.

This article is a revised and updated version of one that had appeared previously on www.crevelingandcreveling.com.

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