



# UNDERSTANDING PREMIUM OFFSET IN PARTICIPATING INSURANCE POLICIES



## INTRODUCTION:

Participating (par) life insurance policies are a type of life insurance that offers both a death benefit and significant potential for dividend earnings. The dividends earned inside par policies can be used in various ways to enhance the policy's value and benefits. One such method is premium offset, a powerful strategy that can significantly benefit policy owners.

Participating insurance policies are life insurance policies that allow policyholders to share in the profits of the insurance company. These profits are distributed as dividends, which can be used in several ways:

- **Cash Payout:** Dividends can be received in cash.
- **Premium Offset:** Dividends can be applied to reduce or fully offset the annual premium.
- **Dividend Accumulation:** Dividends can be left to accumulate with interest.
- **Purchase of Paid-Up Additions (PUAs):** Dividends can be used to buy additional insurance coverage, which increases the policy's cash value and death benefit.
- **Loan Repayment:** Dividends can be used to repay any outstanding policy loans.

## WHAT IS PREMIUM OFFSET?

Premium offset is a strategy where the dividends generated by a participating insurance policy are used to pay the policy premiums. This can potentially eliminate the need for the policyholder to make out-of-pocket premium payments while maintaining the policy's benefits.

## HOW PREMIUM OFFSET WORKS:

**Dividend Generation:** As the insurance company earns profits, participating policyholders receive almost all those profits as dividends. The size of dividends depends mainly on the company's investment performance and actuarial experience.

**Dividend Allocation:** Instead of receiving dividends in cash, the policyholder chooses to apply these dividends towards the policy premium.

**Premium Offset:** When the dividends are sufficient, they can cover the entire premium. If not, the policyholder pays the difference.

**Paid-Up Status:** Over time, with consistent dividend earnings and potentially the purchase of PUAs, the policy can reach a point where it becomes "paid-up." This means no further premiums are required, and the policy remains in force for the life of the insured.



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## ADVANTAGES OF USING PREMIUM OFFSET:

**Reduced Out-of-Pocket Costs:** The most immediate benefit is the reduction or elimination of out-of-pocket premium payments. This can be especially advantageous in retirement when income might be lower.

**Financial Flexibility:** By using dividends to pay premiums, policyholders can free up cash for other financial needs or investments. A single year's premium can be offset, and the later years can be paid again in cash.

**Tax Advantages:** Dividends used to pay premiums are usually not taxable. This makes par policy dividends an extremely tax-efficient income stream to own.

**Policy Sustainability:** Using dividends to offset premiums helps ensure that the policy remains in force without the need for additional out-of-pocket payments, reducing the risk of death benefit reduction or policy lapse.

## CONSIDERATIONS AND POTENTIAL DRAWBACKS:

**Dividend Variability:** Dividends are not guaranteed and can fluctuate based on the insurance company's performance. Policyholders should be aware that in years with lower dividends, they may need to pay some premiums out of pocket.

**Policy Loans and Withdrawals:** Borrowing against the policy or making withdrawals can reduce the cash value and dividends, impacting the ability to offset premiums.

**Cost of Insurance:** As the insured ages, the cost of insurance increases. While dividends can help offset this cost, there may be years where dividends are insufficient, requiring out-of-pocket contributions. It is important to consult an advisor when considering premium offset for this reason.

**Long-Term Planning:** Effective use of premium offset requires careful planning and regular review of the policy performance. Policyholders should work closely with their insurance advisor to ensure the strategy remains viable.



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## CASE STUDY:

Lisa, a 45-year-old dental professional, purchases a participating whole life insurance policy with twenty annual premiums of \$50,000. She decides to use the dividend option to purchase PUAs to increase her policy's cash value and future dividends.

### Year 1-10:

Lisa consistently receives dividends, which she uses to buy PUAs.

Her policy's cash value and death benefit increase each year.

By year 10, the accumulated cash value and additional PUAs generate sufficient dividends to cover 60% of her annual premium.

### Year 11-20:

With continued dividends and PUAs, by year 14, the dividends fully cover her \$50,000 annual premium.

Lisa no longer makes out-of-pocket premium payments.

By year 20, her policy is fully paid-up, and no further premiums are required.

## RESULT:

Lisa enjoys a robust life insurance policy with a significant tax-sheltered cash value.

She has financial flexibility, using the cash that would have been paid as premiums for other investments.

In retirement, Lisa can leverage her policy's cash value through loans or withdrawals if needed.

## CONCLUSION:

Premium offset is a valuable strategy for participating insurance policy owners, offering reduced out-of-pocket costs, enhanced financial flexibility, and tax advantages. By understanding the mechanics and benefits of premium offset, policyholders can effectively use their dividends to maintain their life insurance policy while optimizing their financial planning.

Consult a Unity advisor to learn how and strategic use of premium offset can amplify the benefits of owning a participating insurance policy, throughout your life.