Money

WHAT IS A DEATH BENEFIT?

By: Mallika Mitra - May 17, 2021

Adeath benefit is a sum of money paid out to the beneficiary or beneficiaries of a life insurance policy, as long as the insured died while the policy was in effect.

The death benefit is the primary purpose of buying life insurance coverage; it's what your premium payments cover throughout the life of your policy.
Life insurance pays out a tax-free death benefit if your policy is active when you die.

There are several different types of life insurance policies, but the main categories are term life insurance — the more affordable option — and permanent life insurance.

Term life insurance policies are in force for a set period or term, which typically range in length from 10 to 30 years. If the insured dies within the policy term, the insurer pays out a death benefit equal to the policy's face value.

Unlike term life insurance, permanent life insurance policies such as whole life insurance do not have an expiration date. Rather, they remain in force as long as premiums are paid. If the insured dies while the policy is in force, the death benefit is paid out to the beneficiaries.

Lump-sum payments vs. annuitized payments

The most popular ways to cash out a death benefit is receiving it as a lump sum payment or as an annuity — a monthly or annual payment. Most beneficiaries choose the lump sum payment and work with their financial planner or advisor to set up a financial plan.

With a lump sum payout, you will receive the total amount of the benefits tax-free. This money can be used to pay for funeral expenses, mortgage payments and income replacement. When you fill out the death benefit claim, you can choose if you'd prefer a direct deposit or a check.

If, on the other hand, you choose to "annuitize" your death benefit, the funds would be put in an investment account called an annuity. From there, beneficiaries can receive monthly or annual payments for a set number of years — typically 10 to 30. The annuity earns a modest but steady amount of interest.

The main difference between an annuitized death benefit and a lump-sum payment is that the lump-sum payment is tax-free, while a portion of the income stream the annuity provides could be taxable.

What happens to the cash value component of whole life insurance after you die?

Whole life insurance and other permanent life policies feature a savings component called cash value, which functions as a guaranteed investment that grows at a slow rate.

The cash value savings component is a living benefit, meaning it will be paid to you while you're alive should you ever decide to surrender the policy. However, the cash value won't increase the death benefit your life insurance beneficiaries will receive upon your death.

For example, if you had a $1 million policy with $500 in the cash value savings component, your heirs would only receive $1 million upon your death, according to Todd B. Hall, CFP and director of financial planning at Homrich Berg.

However, you could add an optional insurance rider that would pay out both the cash value and the face amount of the whole life policy. This rider would increase your premiums further compared with a term life insurance policy with the same death benefit.

You can also take loans from the funds available in your cash-value account, but if you don't repay them, the outstanding loan amount will be deducted from your beneficiaries' death benefit.

How to claim a life insurance death benefit

Once the life insurance policy owner dies, the designated beneficiary or beneficiaries can claim the death benefit. They can do so by submitting a copy of the insured's death certificate, along with the policy number, with the life insurance claim form.

Life insurance companies typically take up to a month to review a claim before paying out the death benefit. They may request further documentation.

Documents required to file a life insurance claim

- Certified copy of the death certificate
- Life insurance policy document or policy number
- Claim form

Steps to filing a life insurance claim

- Call the insurer with the policy number and the insured's details.
- Complete and submit a life insurance claim form (some companies have an online process, while others send a letter).
- Attach a copy of the death certificate and other required documents.
- Allow 5-7 days for processing and approximately 30 to 60 days to receive the funds.
- Once the claim is submitted, determine how the proceeds will be distributed.

Why might a life insurance claim be denied?

According to a spokesperson for the American Council for Life Insurers (ACLI), less than 0.5% of life insurance claims were disputed at the end of 2019. Although it is not common for claims to be denied, there's a variety of reasons why your death claim might be rejected.

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How do beneficiary designations work?

Death benefits are paid out to the beneficiaries you named on your policy. Your life insurance beneficiaries can be one or more persons, a trust that is managed by a trustee, a charity or your estate.

You can set up primary beneficiaries and contingent beneficiaries. If you die, your primary beneficiaries are the first in succession to receive the death benefit. If your primary beneficiaries die before you, the death benefit will go to your secondary or contingent beneficiaries.

Beneficiary designations can be changed at any time, but you should update this information whenever you experience a life event such as a marriage or divorce. The death benefit will be paid out to the person or persons listed on the beneficiary designation, regardless of the instructions on your will.

Do you have to pay out-of-pocket for funeral expenses?

Most funeral homes request payment up-front, so your surviving family members will have to pay for the expense out of pocket. According to Walker, the amount depends on whether you choose cremation or burial, which can range between $7,000 to $12,000. The death benefit, then, should exceed these costs.

Some life insurance companies will also offer an expedited payout for funeral expenses, says Neel Shah, estate planning attorney and CFP at Beacon Wealth Solutions.

There's also the option to pre-pay for your funeral expenses, so your heirs don't have to come up with the money after you die.

What can I do if someone died but didn't leave a copy of their life insurance policy?

If you believe you're the beneficiary of a policy, you can take steps to find and obtain your benefits. According to Wilson Coffman, founder of Coffman Retirement Group, you should first check your loved one's bank and credit card statements for any payments made to insurance carriers.

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