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Funding a Special Needs Trust with Life Insurance: The Basics

Among the many challenges for families is making sure there will always be enough money to provide lifetime care for their special needs children. The costs are daunting: therapies, housing, medical care, and education, to name just a few. One way to plan for this challenge is to set up a special needs trust . Families of modest means may hesitate, thinking they don't have the savings to put money aside in a trust. A solution for them is to fund a special needs trust with life insurance. In these instances, a parent will take out a life insurance policy on his life to ensure that once he passes away, sufficient funds will be available to care for the special needs child.

How does it work?

The trust is the beneficiary of the life insurance policy, so the funds from the death benefit go straight to the trust when the insured person dies. Because the trust has been set up for the benefit of the special needs person, the money pays for that person's care and support throughout her life.

What are the advantages of funding a special needs trust with life insurance?

The purpose of life insurance, in any situation, is to provide immediate funds to a family when its main breadwinner dies unexpectedly. This will ensure that the surviving family members can meet their basic needs without exhausting their savings or going into debt.

Having sufficient cash flow is critically important to families with special needs children. Essential services such as therapies, housing, and medical care should never be interrupted, especially in the event of an unexpected death.

Additionally, the death benefit of a life insurance policy flows to the trust quickly and usually free of taxation. And the amount of the death benefit is guaranteed and delivered as cash (not securities or bonds), so it is not subject to the ups and downs of the stock market.

What are some other considerations?

When considering life insurance, consult with your special needs planner to make sure you are applying for enough in benefit. If your policy is too small and you encounter health problems later on, you run the risk of becoming uninsurable and won't be able to purchase more.

Also, understand the different types of life insurance. To fund a special needs trust, the best option is some form of permanent life insurance, which will guarantee to pay the death benefit to the trust no matter when you pass away. Term insurance, which only lasts for a specified period of time, may be less expensive but is not an appropriate way to fund a special needs trust. You run the risk of outliving the policy, with the result that the trust will no longer be funded by the death benefit once you're gone. Couples will often purchase what's known as a second-to-die or survivorship life insurance policy, which covers the lives of both parents. The policy will pay the death benefit to the special needs trust once the surviving parent passes away. A survivorship policy will cost less than two separate policies on each parent.

Lastly, don't wait! Perhaps your health is at its best right now, depending on your age and health. If so, now is the best time to apply, for the highest rating and lowest premiums. Your special needs planner can help you decide whether funding a trust with life insurance is a good investment for your family, and if so, how much.