White Paper – Life Insurance for Estate Planning

Life insurance is protection for those left behind after the death of someone important to a family or business. Many times families are devastated financially by the loss of a key breadwinner who supports a family, businesses close or are sold to unrelated parties due to the death of a key employee or owner, and estates are broken up and paid away in taxes after the death of someone with substantial assets who failed to properly plan for their death.

What life insurance does is provide a lump sum of money (or a stream of money in some special cases, and also in some cases additional benefits) to those left behind after the death of the insured person. The cash payment is used as needed/desired by those who are the beneficiaries. The policy is purchased by the policy owner who is often the insured as well. The benefits paid to the beneficiaries are most typically family members left behind and generally the money is used to pay final expenses and ensure the family members left behind are able to financially survive the next several years of their lives.

Families typically buy life insurance to insure the main breadwinners and also on the main caretaker of the children. The loss of the breadwinner (person who earns the primary income used to pay for housing, transportation, insurance, food, and other needs) can create for many families' situations where the existing lifestyle will change dramatically. Thus, for families the cash death benefit of a life policy helps replace income lost with the death of the breadwinner. In the case of a stay at home spouse who cares for kids, the insurance offers cash necessary to hire domestic assistance who help with the chores and child care once provided by the stay at home spouse.

In special need circumstances such as estate planning or business owners the cash benefits are there to help pay estate taxes or buy out the deceased partner's estate out of the business. There are other special cases for life insurance but generally the payout goes towards specific needs of the special situation, such as trust funds to care for relatives who are otherwise unable to care for themselves. For brevity we will not try to cover all special circumstances here.

The purchase of a life insurance policy has several components. (1) Identify and quantify the need; (2) Identify the appropriate carrier based on insured health and insurance need; (3) Write an application for insurance; (4)Submit the application for Underwriting; (5) Complete Underwriting, which may include medical exams (often called a paramed exam), review of medical records, review of the MIB (Medical Information Bureau) reports, or review of special circumstances; (6) Receive a policy, counter offer, rejection, or postponement from the insurance company, and finally (7) Implementation of the policy.

The underwriting process and timeline are important especially when purchased for special needs. There may be circumstances when temporary coverage is available but often it is not for special needs type coverage or for death benefit level requested. The process of underwriting is generally described above. In addition to the above it is important to know and understand that the underwriter is dependent on many others to get the process completed. The insured also can impact the process by responding timely to additional information requests and completing any paramedical reviews requested timely.

Generally a life insurance policy, except for instant or rapid issue low death benefit higher cost policies, will take a month to three months to go from application to policy issued in force. The time line is affected primarily by securing medical records, getting the para-medical review completed, and providing answers asked by the underwriter. Medical record acquisition is typically the biggest hold-up for most life insurance cases.

When a life insurance company wants to review medical records it is typically for a more in depth review of a medical situation listed on an application. For instance if someone lists high blood pressure with a single medicine to treat it and associated tests when the diagnosis was rendered, it is likely the underwriter will want to review the medical records from the cardiologist to validate the information on the application, especially if the diagnosis is within the past year. This helps determine if there are other medical conditions likely to develop which would affect the rating issued by the insurance company. Because this information is needed to fully understand the health status of the applicant the insurance company requests the medical records.

Companies that specialize in securing medical records are used to secure the medical records from the attending physician. These companies have different ways of securing the records. They do pay physicians to produce the records, and provide to the physician the signed HIPAA authorization which is part of the application. Why then is this a slow down spot in the processing of an application? Often doctor's offices are very slow to respond to requests for medical records even though they are being paid. The proposed insured can help speed this along by letting the doctor's office know the importance of getting medical records to the insurance company if requested.

Once the underwriter has all data about the proposed insured, they will review the health status and based on internal guidelines set by each carrier, which are unique to the carrier, the individual is scored and based on the score assigned a rate for the policy requested. Thus health status, amount of insurance requested, amount of insurance to be held in total, and the length of a rate guarantee all will factor into a final rate. Insurance type is a key factor in determining the price of a policy. Term insurance is less expensive than permanent insurance. Shorter terms 10 years are less expensive than 20 or 30 years, but of course if you need the policy longer than the initial term the rates go way up.

Estate Planning is one of the often cited purposes for a life insurance purchase. The reason for the life insurance is not to leave cash behind for survivors to use for their own needs but instead it is left to help pay or totally pay any estate taxes that may be due on the estate of the insured individual. Life insurance, typically permanent policies because it is expected they will be kept until a death occurs, are purchased in amounts expected to be adequate to pay some, most, or even all of the estate taxes which would be due at the time of the death of the insured. This allows the full value of the estate to go to the heirs as desired.

Life insurance proceeds are counted as part of the estate of the person who owns the policy, so often a trust is set up to both own the insurance and receive the benefits. The trust has to be set up in a manner that it defines who has access to the cash deposited and for what use the money can be used. It often

also needs to specifically indicate primary and secondary beneficiaries for the trust. With a proper trust the death benefits can be used to pay estate taxes and/or provide for the needs of a surviving spouse.

The reason many use the life insurance for the payment of the estate taxes is to ensure the full value of their estate is passed along to beneficiaries (people, companies, or charities). These individuals often see the cost of the insurance as a small price to pay to ensure their beneficiaries don't receive less than the full value of the estate. This also allows a long term payment stream to be made to cover the estate taxes. Further with a good Whole Life or Universal Life policy, it's possible that the cost of the coverage will be far less than the actual estate taxes which if viewed from an actual total cost vantage point, it is the most economical way to cover the estate taxes costs.

In addition to paying estate taxes there are other special uses for life insurance. Among these include funding buy-sell agreements, covering the costs associated with the loss of a key person at a company, funding legacy donations to charities or foundations, and funding legacy trusts that are there to support economic needs of future generations.

Here are some statistics about life insurance and estate tax:

- In addition to Federal Estate Taxes some states have Estate taxes (with some using very low limits that trigger up to 20% estate taxes in the state on top of Federal). Exclusions exist for transfer to spouses and specific other situations.
- 30% of US Households have no life insurance *
- 44% of Households have individual life insurance *
- 1/3 or more of homes with $100,000 annual income are underinsured *
- Currently there is a $5,000,000 exemption on Estates under the Federal Death Tax although passing the estate to a spouse is allowed with unlimited wealth transfer.

(* = LIMRA Life Facts 2010)

Definitions to know:

Proposed Insured / Insured – the person on who the insurance is provided

Insurer – The company licensed in the state in which a policy is issued, who provides a guarantee thru the form or an insurance contract, to pay a specific death benefit at the time of the death of the Insured, less any policy loans or other contractual deductions.

Policy Owner - Individual or entity who owns the policy, it may or may not be the same as the Insured

Policy Beneficiary / Beneficiary – The person(s) or entity that receives the payout of the death benefit at the time the Insured dies.