



# Life Insurance: Protection Planning

## What is Life Insurance?

Life insurance is a legal contract between a policyowner and an insurance company, governed by state law. In exchange for premium payments, the insurer agrees to pay a specified death benefit to a named beneficiary upon the death of the insured. The policy outlines the rights, obligations, and conditions that apply to both parties.

The primary purpose of life insurance is to replace the economic loss that results from a person's death. By pooling relatively small premium payments from many individuals, insurers create a source of funds to provide financial protection for families, businesses, and other beneficiaries.

## How Life Insurance Works

### *The Application Process*

The first step in obtaining life insurance is completing an application. Insurers typically request information such as:

- Age, residence, and occupation
- Income and financial background
- Tobacco, alcohol, and drug use
- Driving record and hazardous activities
- Travel history
- Existing insurance coverage
- Personal and family medical history

Most insurers participate in the **MIB Group** (formerly the Medical Information Bureau), a nonprofit organization that maintains a database of application and claims information. Insurers use MIB data to verify application information and help prevent fraud.

Providing inaccurate or incomplete information—particularly regarding health—may result in denial of coverage or future policy rescission. If material misstatements are discovered after a policy is issued, insurers may adjust premiums or void coverage depending on the timing and severity of the omission.

### *The Medical Exam*

Depending on the applicant's age, health, and the amount of coverage requested, a medical exam may be required. Exams are typically conducted by a licensed health professional and may include measurements, blood work, and other tests such as an EKG. The insurance company generally pays for the exam, and results are reviewed by the underwriter.

Applicants may request copies of their exam results.

Securities, investments, investment advisory services and insurance:

Are Not FDIC Insured | Offer No Bank Guarantee | May Lose Value | Are Not Insured By Any Federal Government Agency | Are Not a Deposit



### *Underwriting*

Underwriting is the process by which an insurer evaluates risk. Underwriters review the application, medical exam results, and third-party reports to determine whether coverage will be issued and at what premium rate. Applicants may be approved at standard rates, approved with higher premiums, or declined based on risk factors.

### *Premium Pool and Claims Payment*

Premiums collected by insurers are used to cover expenses, taxes, and mortality costs, with the remaining funds invested according to the policy type. When a covered individual dies, the insurer pays the death benefit to the beneficiary using pooled premiums and investment earnings.

## **When Life Insurance is Used**

### *Personal Uses at Death*

- **Paying Final Expenses:** Life insurance can provide immediate funds to cover funeral and burial costs, which now commonly range from **\$8,000** to **\$15,000** or more depending on location and services. Because proceeds are typically paid quickly and income-tax free, life insurance is often an efficient way to handle these expenses.
- **Providing Financial Support for Dependents:** A primary reason for life insurance ownership is income replacement. When a wage earner dies, household expenses continue, including housing, food, healthcare, transportation, and education. Life insurance can help maintain financial stability for surviving dependents.
- **Paying of Debt:** Life insurance proceeds can be used to pay mortgages, auto loans, credit cards, business obligations, or student loans. While death does not eliminate contractual debts, insurance can help prevent surviving family members or co-signers from bearing the burden.
- **Paying Estate Taxes:** Even individuals who do not consider themselves wealthy may face estate tax exposure depending on federal and state laws in effect at death. Life insurance can provide liquidity to pay estate-related costs without forcing heirs to sell assets under unfavorable conditions.
- **Creating an Estate:** Life insurance can be used to create an estate when sufficient assets have not been accumulated during life. Premiums paid over time may generate a death benefit substantially greater than the total premiums paid, creating a meaningful legacy for beneficiaries.

### *Personal Uses During Lifetime*

Permanent (cash value) life insurance policies accumulate cash value that grows tax-deferred. Policyowners may access cash values through loans or withdrawals for purposes such as retirement income or education funding. Loans and withdrawals may reduce cash value and death benefits and can have tax consequences.

## **Business Uses of Life Insurance**

### *Employee Benefit Programs*

Many employers offer group life insurance as an employee benefit, often at little or no cost to employees. Coverage amounts are frequently based on multiples of salary.

**Important:** Employer-provided coverage in excess of **\$50,000** may result in taxable income to the employee.

### *Key Person Insurance*

Businesses may insure key executives or employees whose death would result in significant financial loss. Life insurance proceeds can help offset lost revenue, recruitment expenses, and operational disruption.

Securities, investments, investment advisory services and insurance:

Are Not FDIC Insured | Offer No Bank Guarantee | May Lose Value | Are Not Insured By Any Federal Government Agency | Are Not a Deposit



### *Buy-Sell Funding*

Life insurance is commonly used to fund buy-sell agreements, providing liquidity to purchase a deceased owner's interest. Cash value policies may also be used to help fund buyouts for retiring owners, creating an orderly ownership transition.

## **Determining the Right Coverage**

### *Needs Analysis*

A needs analysis evaluates the financial impact of death on a family or business. It considers income replacement needs, assets, liabilities, ongoing expenses, and long-term goals such as retirement, education, and estate planning. The results help determine the appropriate amount and type of coverage.

### *Affordability*

Coverage should align with both insurance needs and budget constraints. Even individuals with limited cash flow may find suitable options, such as term insurance, to address critical protection needs.

## **Common Life Insurance Mistakes**

- **No insurance:** Delaying coverage can leave loved ones financially vulnerable.
- **Not enough insurance:** Coverage may become insufficient as responsibilities grow.
- **Too much insurance:** Excess coverage can lead to unnecessary premium expense.
- **Wrong type of insurance:** Choosing between term and permanent insurance requires careful consideration of goals, duration of need, and affordability.

Regular reviews—typically every one to three years or after major life events—help ensure coverage remains appropriate.

## **Tax Considerations**

To qualify as life insurance for tax purposes, policies must meet specific federal requirements, including tests related to cash value accumulation, premium limits, and death benefit corridors.

In general: - Premiums are **not tax deductible** - Death benefits are **generally received income-tax free** - Transfers of policies for value may cause some proceeds to become taxable

### *Gift and Estate Tax Considerations*

- Death benefits are generally not treated as gifts to beneficiaries
- Premium payments may be considered gifts if paid on policies owned by others
- Policy proceeds are typically included in the insured's estate if incidents of ownership were retained within three years of death

Proper ownership and beneficiary structuring can help manage estate tax exposure.

## **Choosing an Insurance Company**

Selecting a financially strong insurer is critical. Independent rating agencies such as **A.M. Best, Moody's, Standard & Poor's, Fitch, and TheStreet** evaluate insurers' financial strength and claims-paying ability. Service quality is also important. Prospective policyowners may review consumer complaint records through state insurance departments and seek referrals from trusted professionals.

Securities, investments, investment advisory services and insurance:

Are Not FDIC Insured | Offer No Bank Guarantee | May Lose Value | Are Not Insured By Any Federal Government Agency | Are Not a Deposit



---

## IMPORTANT DISCLOSURES

One Resource Group does not provide investment, tax, or legal advice. The information presented here is not specific to any individual's personal circumstances.

To the extent that this material concerns tax matters, it is not intended or written to be used, and cannot be used, by a taxpayer for the purposes of avoiding penalties that may be imposed by law. Each taxpayer should seek independent advice from a tax professional based on his or her individual circumstances.

These materials are provided for general information and educational purposes based upon publicly available information from sources believed to be reliable - we cannot assure the accuracy or completeness of these materials. The information in these materials may change at any time and without notice.

Securities, investments, investment advisory services and insurance:

Are Not FDIC Insured | Offer No Bank Guarantee | May Lose Value | Are Not Insured By Any Federal Government Agency | Are Not a Deposit