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HEG86-208 Life Insurance Insights

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Life Insurance Insights

This guide defines life insurance, its purpose, who needs it, types of policies and companies, how to choose the right insurance, and offers suggestions for policyholders.

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Life insurance touches nearly every man, woman and child in the country. Every week of the year, people buy almost a million life insurance policies.

What Is Life Insurance?

Insurance companies help take the financial sting out of a loss of life by collecting money from the subscribers to the program, investing the amount, and distributing a sum of money back to the subscriber or to the subscriber's estate after death.

Financially, most people can justify the cost of having some life insurance. Life insurance is one means of adding to or building an estate. Life insurance also acts as a protection against loss of the insured's income or assets.

What Is The Purpose Of Life Insurance?

Life insurance is protection for dependents. Your dependents can include children, parents, spouse, or anyone who is dependent on you for financial support. In a sense, creditors are also "dependents" in that they are depending on you to repay your debt. So creditors should be added to your list of dependents.

Life insurance is not an investment nor is it a savings plan. The American Council of Life Insurance (ACLI), a trade association in the life insurance industry, said in an issue of their newsletter:

Life insurance is not designed to provide for the possibility of economic gain in return for a risked sum of money. That's an investment. Nor is it designed to accumulate deposits of money building toward an individual or family financial goal. That's a savings account. The purpose of life insurance is "to provide a guaranteed death benefit to protect your dependents against financial loss."

Who Needs Life Insurance?

Someone may tell you that **everyone** needs life insurance. According to another ACLI publication:

Anyone needs life insurance if his or her premature death would result in financial loss to others or deprive them of a financial gain.

In other words, the need for life insurance depends on a person's situation.

For information and answers to specific questions about your life insurance policies, contact your agent or the representative for your group life insurance plan.

To get the best possible life insurance coverage for your family, you need to know what kinds of policies are available from which sources, and how to choose a policy to fit your situation.

Five Basic Types of Policies

Of the more than 100 different kinds of life insurance on the market today, all can be grouped into one of five main categories. By looking at how each type works, its advantages, and disadvantages, and types of situations appropriate for each type, you will be able to make the best decision about which type of life insurance is best for you.

Term Insurance

Term insurance is relatively cheap especially if you don't have many assets or emergency reserves, but do have financial dependents. Many term policies offer a guaranteed renewable clause which means your right to renew the policy is unrestricted.

Disadvantages of term insurance include the fact that premiums increase at the end of each renewable term because as you get older the chances of your dying increase. Consequently, term insurance may become too expensive in later years.

Situations where term insurance may be the best option include:

1. You just want life insurance protection but at the lowest rate possible.
2. You have other assets and investments for retirement and do not plan to use life insurance to cover that need. In fact, you do not plan to need any life insurance protection after age 60.

Whole Life Insurance

Sometimes called Straight Life Insurance, whole life gives you lifelong protection. Your premiums at the beginning are higher to help cover the costs of providing you that protection later in life when term premiums get costly. The company averages out the cost of giving you life insurance protection for your entire life, then overcharges you when you're young and undercharges you when you're older. Whole life policies build a cash value which you can borrow from the company or redeem by cashing in the policy.

Advantages of whole life include the tax-deferred interest you earn on your cash value (which becomes tax-free if you never take the cash value out of the policy). Loans on the cash value of the whole life are generally less than that charged for loans available elsewhere.

Regular premium payments must be made on whole life or the policy will lapse. Outstanding loans when you die will be subtracted from the amount paid to your beneficiaries. The interest rate credited to the cash value of the policy is usually far below what your funds could earn elsewhere. Cash value grows relatively slowly during the early years of the policy. This means that if you cash in a whole life policy after only five years, you get relatively little back for the relatively higher premiums you've paid.

Whole life is best if you have no self-discipline or tolerance for risk when you save or invest.

Universal Life

First issued in 1980, the universal life insurance policy is a combination of term insurance and a currently tax-deferred saving plan. You are guaranteed a minimum rate of return, but the actual interest rate paid on the savings portion is flexible. After you make the initial premium payment, you can make premium payments at any time and for any amount. If you don't regularly pay premiums, what is in the savings part will cover the cost of regular term insurance. Universal life allows you to increase or decrease the amount of term coverage you have at any time.

Advantages of universal life include that the savings part of the policy usually grows at a faster, higher rate than the cash value of whole life. Your protection under universal remains level while your savings do increase. Earned interest on savings is tax-deferred. For a service charge, you can make partial withdrawals from the savings, and interest paid to borrow from your savings is minimal.

The flexible premium and flexible death benefit in universal life allows you to change your policy as your financial needs change.

The target premiums which you must deposit to realize savings growth and to cover the cost of the term insurance are based not on a minimum guaranteed rate, but on projected interest return. So if interest rates drop, you may have to pay more in premiums to maintain your policy than what you had originally thought. Initial fees and charges mean your savings grow very slowly for the first 10 years of the policy. Always look at the policy's surrender value rather than the stated account value. Term insurance costs more when included in a universal life policy than if purchased alone.

If you like the idea of a combination insurance/savings plan and you are at least somewhat flexible and self-directed in money matters, universal life may be the appropriate type of life insurance.

Variable Life

A guaranteed minimum death benefit is stated but it may increase if the cash value of the policy goes up. The cash value of variable life is invested in your choice of stocks, bonds, money- market funds, and any combination. If your investment choice performs well, the cash value of your variable life policy increases, but a minimum cash value may be guaranteed. Premiums are fixed and level; they are roughly the same as what you would pay for whole life. Many variable life policies also include an annuity feature. Sales people for variable life must be registered with the National Association of Securities Dealers.

If your investments do well, your potential gain with variable life can be great. Cash value of the policy can be divided if you choose to spread the risk among several types of investment vehicles. You can change the "mix" of your investments a stated number of times per year with no charge. No capital gains are due when you switch funds and any gains are tax-deferred. You can borrow the cash value of the policy at competitive or lower than market rates.

A disadvantage of variable life is that you may forfeit the entire cash value of the policy if your chosen investment "mix" performs poorly. Your contract is effectively rewritten if you make partial withdrawals. You receive investment performance reports but no reporting of how your total life insurance premium is spent. In the early years of the policy, the cash surrender value is small because much of the premium you pay goes to cover company expenses and fees. Variable life is best considered a long-term, big-ticket financial commitment.

If you need a tax shelter and are an experienced, risk- tolerant investor, variable life may be the life insurance option for you.

Variable Universal Life Insurance

This policy is a combination of variable and universal life insurance. You can choose where to invest your premium dollar and assume all the investment risks associated with that choice like variable life insurance. Like universal life, you can vary your premium payments and change the death benefits of the policy.

The ability to hedge your investment bets by choosing different types of investments and the ability to change investment vehicles free of charge a certain number times per year are among the advantages of variable universal life insurance. When you change investment vehicles there are no capital gains. Any investment gains are tax-deferred. You have great flexibility in varying the frequency and amount of premium payments. Partial withdrawals in the terms of loans are possible. If you furnish proof of insurability, you can increase or reduce amount of coverage.

Disadvantages of variable universal life insurance include the potential risk involved. Generally the term insurance within this policy is more costly than buying term insurance outright. Since there are no fixed premium payments, there is no incentive to save or invest. Experts suggest holding a variable universal life policy at least seven to ten years since fees and charges in the early years of the policy, while not as steep as with universal or variable policies, are still significant.

Variable universal life insurance may be the best life insurance option for you if you need a tax shelter and are comfortable with high risk/reward investing.

Types Of Insurance Companies

Most companies sell the five basic types of life insurance. Keep in mind that life insurance should be purchased from an established and reliable company because you pay in the present and expect protection long into the future.

Stock Insurance Companies

Stock insurance companies are profit-making corporations owned by stockholders who are not necessarily policyholders. Policies are usually sold as "nonparticipating" insurance, meaning they do not earn policy dividends for policyholders.

Mutual Companies

Mutual companies are owned by the life insurance policyholders. Mutual companies sell "participating" policies which means that dividends may be paid to the policyholder. These dividends are a result of the company charging too high a premium rate for a particular year. Investment earnings of the company may be higher than expected or company expenses could be less than planned. Dividends may be taken as cash, applied to the following year's premium, used to purchase paid-up additions to the policy, or left to accumulate interest to add to the cash value of the policy.

Professional, Fraternal and Religious Companies

Professional, fraternal and religious companies operate in a different state from which you live. Usually all business is done through the mail without the services of a local agent. Costs may seem low but the counseling advice from the agent is missing. It is wise to write for a specimen contract of the policy and examine it carefully before purchase.

Check with the State Insurance Commissioner's office to see if the company is licensed in your state.

Life insurance may be purchased as an individual life insurance purchase from a company agent or through a

group plan where you are a member of that group.

Individual Life Insurance

Individual life insurance sold as an individual purchase from a company agent offers term, whole life, limited payment and endowment type policies. Medical examinations are usually required before coverage is issued. A certificate called a policy is given to the individual as proof of being insured.

Group Life Insurance

Group life insurance is generally offered as term insurance through the group from an insurance company and requires no medical examination. Premium costs are lower in a group plan because there are fewer operating expenses. As the employee leaves the job or retires, the protection ends. It is sometimes possible to convert the term group policy to a permanent form of insurance, if done within 30 days of leaving the group.

Words You Need To Know

Being aware of the various contract clauses and provisions available will help you select the ones most suitable for your situation. Most of these provisions will add to the cost of the insurance premiums.

Face Value

Face value of a policy is the amount stipulated in the contract when the policy is written. A \$10,000 life insurance policy has a face value of \$10,000 which will be paid at the death of the policyholder.

Accidental Death Benefit

An accidental death benefit or "double indemnity" promises to apply an additional sum equal to the face value of the policy if accidental death occurs to the insured. This feature adds to premium cost.

Disability Income Rider

The disability income rider is a provision that pays the insured a set amount per month after the first six months of disability. This feature adds to premium costs. Check your policy for exact amount.

Guaranteed Insurability

Guaranteed insurability or the "additional purchase benefit" is an option on permanent policies allowing the policyholder to purchase additional insurance even if you have become uninsurable. A fee is added to the basic premium costs so additional insurance can be purchased every three years, usually starting at age 25 and ending at age 40.

Incontestable Clause

The incontestable clause states that after the policy has been in force for one or two years it can't be contested by the company. This fixes the time limit on the company to check and verify all information within the time period. Some companies make suicide a contestable issue for longer periods of time. No added premium costs are charged.

Policy Loan Provision

A policy loan provision allows the policyholder to borrow on permanent life insurance any amount up to the

current cash value of the policy by paying interest. No added premium cost is charged.

Waiver of Premium Benefit

The waiver of premium benefit means that if the policyholder becomes disabled for a total period of six months or less, all premiums are paid by the company from the time of the disability. This adds to the premium costs.

How To Choose Your Life Insurance

Deciding what kind and how much insurance to buy will take study. You can't do a good job on a hit-and-miss basis. Actually, the job will never be finished. Both your situation and insurance policies and provisions will change, so new possibilities will be open to you. No one can give you an exact formula, but you might keep these suggestions in mind:

1. Study your needs as a family. You must make the decisions as to which are the most important needs now and how much you can afford to pay for insurance that will protect you in the future.
2. Insure **first** the risk that would be most damaging if it occurred.
3. Review your insurance needs at least annually and more often if there is a change in the family: marriage, birth, new home, more possessions, etc.
4. Select an agent you can trust. Your most valuable guide in buying insurance is a reputable agent. A competent agent will take into account your needs now and any future needs you may have. You will want to review your program with your agent periodically as family needs change. Having an agent you can trust will ensure that you are not over- or under-protected with insurance.

The State Department of Insurance will tell you if the company is licensed in the state. Judgments are not made on rating various policies, but the department will not be aware of improper sales techniques used in your home unless a complaint is made. If in doubt of the agent's statements, ask the agent to put the material in writing with a signature. (Nebraska Department of Insurance, Terminal Building, 941 "O" Street, Lincoln, NE 68508-3609)

After You've Decided Which Type of Life Insurance

Premium rates for the same type of policy vary significantly from company to company.

If you're buying whole or variable life, compare death benefits and annual premium payments; guaranteed cash-value growth (projected investment yields) throughout the life of the policy; loan rates; how annual dividends (if any) offset the premium costs; and cost index numbers (the smaller the index number, the lower the cost).

When buying universal or variable universal insurance, compare interest rates on projected investment returns; premium payments; cash surrender values; loan rates; one-time or first-year fees; recurring fees; insurance costs; withdrawal charges.

Pointers For Policyholders

- Take advantage of group life insurance coverage. The costs to you are very low compared with individually obtained policies.
- Read your insurance policy. Be sure you understand its basic provisions and benefits. Don't hesitate to ask questions. Ask your agent, or write the company or your state insurance department.
- Keep your policy in a safe place. Let your beneficiaries know where your policies are. Your beneficiary must turn the policy over to the company and give proof of your death before collecting on the

insurance. If your policy is lost or destroyed, your company will issue you another copy, as long as you have the policy number.

- Discuss your insurance with your family and other beneficiaries. Have them share in planning the life insurance program. Also discuss each addition or change in the program with them. It is a good idea to write a letter (put in a safe place) describing your insurance policies. State any choices the beneficiary may have in settlement. Point out that your life insurance agent will help your beneficiary fill out the "proof of claim" papers.
- Review your insurance program periodically. The wise person will review insurance coverage from time to time, particularly when there is a change in family situation, for example when children are grown and have left home. Insurance that was sensible for you at age 20 may no longer fit your needs when you are 40 or 60. Get help when you rearrange your insurance program to meet your changing needs.
- Keep your insurance company informed of your address. This is important so the company can send your premium notices and perhaps other important notices.
- Consider buying a disability waiver-of-premium clause. For just a few dollars more a year, your insurance will remain in force if you should become disabled and unable to pay the premium.
- Use dividends to buy additional insurance coverage.
- Don't let life insurance dividends accumulate with the insurance company if they could be earning more money somewhere else and if you have the willpower to follow through with such an investment program.
- Never finance cash value life insurance.
- Check out companies who offer discounts on premiums for people who do not smoke, if you are a nonsmoker.

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