

**TOPIC 1: LIFE INSURANCE CONCEPTS---Four Classroom Hours**

Obj 1-1. **THE FAMILY PURPOSES OF LIFE INSURANCE** include

1. providing immediate funds,
2. providing income to family survivors,
3. repaying debt,
4. paying death taxes,
5. funding dependents' educations,
6. funding trusts,
7. making charitable donations,
8. supplementing retirement income, *and*
9. transferring assets to younger generations.

**THE BUSINESS PURPOSES OF LIFE INSURANCE** include

1. key person indemnification,
2. business continuation, *and*
3. protection for employees and executives.

Obj 1-2. **TERM LIFE INSURANCE** provides level protection for a specified period at a premium that increases for each subsequent policy period.

**Renewability provisions** let the insured continue protection at the end of each coverage period, usually without proving insurability.

**Convertible policies** let the insured convert the term policy to a permanent type of policy, usually *without* proving insurability since conversion results in the insurer bearing *less* risk.

**The two policy conversion methods:**

1. **The original age method**--calculates the permanent insurance premium based on the insured's age when the policy was first bought.
2. **The attained age method**--calculates the permanent insurance premium based on the insured's age when the conversion option is exercised.

The attained age method is the more common method.

**FOUR BASIC CHARACTERISTICS OF TERM INSURANCE:**

1. **temporary protection**--for a specified period only,
2. **a renewability provision**--lets the insured renew for additional periods without **evidence of insurability** (proof the insured still meets the insurer's underwriting standards) up to a specified age,
3. **convertibility**--lets the insured exchange the term policy for a cash value policy, *and*
4. **no cash value** (accumulation of invested funds available to the policyholder).

**Use term insurance if**

1. current income is limited,
2. insuring temporary needs, *and/or*
3. guaranteeing future insurability by planning to later convert the policy.

**Limitations of term insurance:**

1. Premiums become prohibitively high at older ages.
2. There's *no* cash value.
3. Coverage ends.

**FIVE TYPES OF TERM INSURANCE:**

1. **Level term**--has level premiums during the stated period of coverage (often 5, 10, 15, or 20 years), *but* the premiums increase *if* the policy is renewed at the end of the policy term. Level term is the most common form of term insurance.
2. **Annual renewable term (ART)**--is issued for a one-year term. The policyholder can renew yearly *without* evidence of insurability, *but* the premium increases every year. There is usually a *limit* to the number of years the policyholder can renew the insurance.
3. **Decreasing term**--has decreasing benefits, but level premiums. *Example:* mortgage protection insurance.
4. **Increasing term**--has increasing benefits at certain ages or upon life events, such as age 27, age 32, or the birth of a child. Increasing term is usually written as a rider.
5. **Reentry term**--has very low premiums during a stated period of coverage (often 10 years), *but* the insured must provide evidence of good health *or* face *much* higher renewal premiums.

Obj 1-3. **WHOLE LIFE INSURANCE** provides

1. **an inside buildup** (periodic growth) in **cash value** (accumulated invested funds available to the policyowner) **and**
2. permanent, lifetime protection at a level premium throughout the insured's life.

**The whole life premium may be paid**

1. in one lump sum (**single-premium whole life**),
2. over a specified time period (**limited-payment life insurance**), **or**
3. throughout the insured's lifetime (**ordinary life or straight life**).

As the cash value increases, the amount of pure insurance protection decreases.

Whole life insurance allows loans to be made against the policy value.

**Three basic characteristics of whole life insurance:**

1. **cash value**--accumulation of invested funds available to the policyowner;
2. **permanent protection**--for as long as the policyowner pays premiums, without worry about expiration, renewal, or convertibility; **and**
3. **potential dividends**--under a **participating policy** (which pays dividends) **but not** under a **nonparticipating policy** (which does **not** pay dividends).

**Use whole life insurance**

1. as a method of forced savings **or**
2. to provide lifetime protection (to pay estate taxes, donate to charity, or care for a young spouse).

**Limitations of whole life insurance:**

1. Whole life insurance is much more expensive than term insurance in the early years.
2. Many people don't buy enough and hence remain underinsured.
3. Whole life insurance pays a low rate of return on the cash value.

***[Ray's rule of thumb #1: If the insurance is needed for more than 5-7 years, use permanent insurance. If not, use term insurance.]***

***[Ray's rule of thumb #2: Buy whole life insurance from a mutual insurer. Buy term and universal life insurance from a stock insurer.]***

Obj 1-4. **UNIVERSAL LIFE INSURANCE** offers flexible premiums and adjustable benefits. Universal life policies offer the policyowner the most flexibility in designing a policy that meets his needs.

**The universal life policy's cash value is represented by an accumulation fund to which the insurer**

1. credits (adds) interest *and*
2. debits (subtracts) a mortality charge and an expense charge.

That separation of the cash value from the death benefit is called **unbundling**.

Universal life was developed to satisfy the 'buy term and invest the difference' mentality of many insureds.

#### **NINE FEATURES OF UNIVERSAL LIFE INSURANCE:**

1. **Flexible premiums**--After the first policy year (requiring the payment of a minimum premium amount on a monthly, quarterly, semiannual, or annual basis), policyowners may pay *any* amount at *whatever* times they choose, even skipping payments, provided the policy's cash value covers the insurer's costs of maintaining the policy.
2. **Target premiums**--Policies usually have a suggested annual level premium that is designed to keep the policy in force.  
*But*, market trends may make the target premium insufficient to maintain the policy. In that case, the policyowner must either *increase* the premium payments or *decrease* the death benefit amount.
3. **Cash withdrawals**--The policyowner may withdraw from the policy's cash value *without* incurring indebtedness or interest charges.  
*No* obligation exists to repay *any* amount withdrawn, *but* withdrawals lower future earnings and death benefits.
4. **Policy loans**--The policyowner also may borrow against the policy's cash value *but* this automatically lowers the investment earnings credited to the cash value.
5. **Choice of death benefits**--**The policyowner has two choices:**
  - a. **Option A--level death benefit**--is similar to that of a traditional whole life policy. The cash value is included within the death benefit. As cash value increases, pure protection decreases, so the death benefits remain level.
  - b. **Option B--increasing death benefit**--maintains a constant amount at risk *in addition to* the policy's cash value. Therefore, the death benefit increases as the cash value increases. Partial withdrawal of the policy's cash value reduces the death benefit payable.
6. **Interest credits**--The policy guarantees a specified *minimum* interest rate.
7. **Mortality charges**--The insurer deducts a mortality charge each month based on the insured's attained age and the policy's current **amount at risk** (death benefit minus cash value under Option A; death benefit under Option B).
8. **Fees**--A large surrender fee is applied against proceeds *if* the policy is surrendered early. The fee decreases to zero over a 10-15 year period. Transaction fees are charged for withdrawals of cash value.
9. **No lapse guarantee**--The flexible premium feature increases the risk of policy lapse due to insufficient premium payments. Insurers guarantee that the policy will stay in force if the actual premium paid meets the requirements stated in the no-lapse guarantee.  
**Insurers use one of two different approaches to the premium requirement:**
  - a. The insured must pay at least the target premium amount on time for a stated period. Any nonpayment or delayed payment negates the no-lapse guarantee.
  - b. The policy cash value must equal at least a specified schedule of accumulation. Failure to maintain a cash value that equals or exceeds the required schedule will negate the no-lapse guarantee.