

# Personal Finance

Class 7: Insuring your resources

Life Insurance

# Life Insurance: An Introduction

- WHAT IS LIFE INSURANCE?

***Life insurance** - Purchase policy; insurance company promises to pay a lump sum at the time of the policy holder's death, or sometimes while they are still alive*

# Life Insurance: An Introduction

- Purpose of life insurance: Protect someone who depends on you from financial loss related to your death.
- Other reasons are:
  - Pay off a home mortgage or other debts at the time of death
  - To leave as part of your estate
  - To save money for retirement or for income or education for children
  - To cover medical expenses and funeral costs

# Life Insurance: An Introduction

- THE PRINCIPLE OF LIFE INSURANCE
  - Mortality tables provide odds on your dying, based on your age and sex
  
- HOW LONG WILL YOU LIVE?
  - Your premium is based on your life expectancy and the projections for the payouts for persons who die

# Determining Your Life Insurance Needs

- DO YOU NEED LIFE INSURANCE?
  - Do you have people you need to protect financially
  - Do you have a partner who works?

# Determining Your Life Insurance Needs

- DETERMINING YOUR LIFE INSURANCE OBJECTIVES

- How much money do you want to leave your dependents should you die today?
- When do you want to retire, and what income do you think you'll need?
- How much will you be able to pay for your insurance program?

# Determining Your Life Insurance Needs

- ESTIMATING YOUR LIFE INSURANCE NEEDS

1. *The Easy Method*

- You will need 70% of your salary for seven years while your family adjusts

2. *The DINK (dual income, no kids) Method*

- $\frac{1}{2}$  debts + funeral expenses

# Determining Your Life Insurance Needs

## 3. *The “Nonworking” Spouse Method*

- Multiply the number of years until the youngest child reaches 18 by \$10,000

## 4. *The “Family Need” Method*

- More thorough than the first three because it also considers employer provided insurance, Social Security benefits, and income and assets

## 5. *Online Calculators and Applications (APPs)*

# Types of Life Insurance Companies and Policies

- Stock life insurance companies are owned by the shareholders
  - 76% are of this type
  - Sell non-participating policies
  - If you want to pay the same premium each year, choose a non-participating policy with its guaranteed premiums

# Types of Life Insurance Companies and Policies

- Mutual life insurance companies
  - 24% are of this type
  - Owned by the policyholders
  - With participating policies the premiums are higher than non-participating policies
  - Part of the premium is refunded to the policyholders annually. This is called the *policy dividend*

# Types of Life Insurance Companies and Policies

- TYPES OF LIFE INSURANCE POLICIES
  - Temporary Insurance (term, renewable term, convertible term, or decreasing term insurance)
  - Permanent Insurance (whole life, straight life, ordinary life, cash value life insurance)
- **Term life insurance**
  - Protection for a specified period of time
  - If you stop paying premiums, coverage stops
  - Renewability: You can renew the policy without having a physical at the end of the term

# Types of Life Insurance Policies

- **Term life insurance**

- Multiyear level term: Most popular form of term insurance
- Conversion option: Can exchange term policy for whole life policy without having a physical
- Decreasing term insurance: Premium stays the same, but the amount of coverage decreases as you age – mortgage insurance
- Return of Premium: Policy refunds every penny of the premiums if one outlives the defined term

# Types of Life Insurance Policies

- **Whole life insurance** - Also called *straight life*
  - You pay a premium as long as you live
  - Amount of premium depends on your age when you start the policy
  - Provides death benefits and accumulates a **cash value**
  - You can borrow against the cash value or draw it out at retirement
  - Look carefully at the rate of return your money earns

# Types of Life Insurance Policies

- **Limited payment policy**

- Pay premiums for a stipulated period, usually 20 or 30 years, or until you reach a specified age (65)
- Your policy then becomes “paid up” and you remain insured for life

- **Variable life policy**

- Minimum death benefit guaranteed, but the death benefit can be greater than the minimum depending on earnings of the dollars invested in a separate stock or bond fund

# Types of Life Insurance Policies

- **Adjustable life policy**

- Whole life insurance policy, but you can change your policy as your needs change. You can change your premium payments to increase or decrease coverage

- **Universal life**

- Gives you more direct control
- Can pay premiums at any time in almost any amount. Amount of insurance can be changed more easily than a traditional policy
- The increase in the cash value of the policy reflects the interest earned on short-term investments

# Types of Life Insurance Policies

## OTHER TYPES OF LIFE INSURANCE POLICIES

- **Group life insurance**
  - Term insurance
  - Often provided by an employer
  - No physical is required

# Types of Life Insurance Policies

## OTHER TYPES OF LIFE INSURANCE POLICIES

- **Endowment life Insurance**

- Provides coverage from the beginning of the contract to maturity and guarantees payment of a specified sum to the insured

- **Credit life insurance**

- Debts such as car loan is paid off if you die
- Also protects lenders
- Expensive protection



# Important Provisions in a Life Insurance Contract

- Naming your beneficiary and contingent beneficiaries
- Length of grace period for late payments
- Reinstatement of a lapsed policy if it has not been turned in for cash
- Nonforfeiture: Keep accrued benefits if you drop the policy
- Incontestability clause: After the policy has been in force for awhile (2 years), the company cannot dispute its validity for any reason
- Suicide clause during first two years

# Important Provisions in a Life Insurance Contract

- Automatic premium loans
  - Uses the accumulated cash value to pay the premium if you do not pay it during the grace period
- Misstatement of age provision
- Policy loan provision to borrow against cash value
- RIDERS: A rider to a policy modifies the coverage by adding or excluding conditions or altering benefits
  - Waiver of premium disability benefit
  - Accidental death benefit - double indemnity
  - Guaranteed insurability option

# Important Provisions in a Life Insurance Contract

- Cost of living protection
- Accelerated benefits, also called living benefits, pay to those who are terminally ill *before* they die
- Second-to-die option, also called survivorship life, insures two lives

# Buying Life Insurance

## FROM WHOM TO BUY?

- SOURCES

- Examine both private and public sources
- Look up the company's rating, in A. M. Best or other rating agencies
- Talk to friends or colleagues

- RATING INSURANCE COMPANIES

- Research ratings on the web  
<http://www.ambest.com>

# Buying Life Insurance

- CHOOSING YOUR INSURANCE AGENT
  - Can friends or parents make recommendations?
  - Does the agent have professional designations such as Chartered Life Underwriter (CLU)?
  - Is the agent willing to find a policy that is right for you or does he push a certain type of policy?
  - Do they ask about your financial plan?
  - Do you feel pressured?

# Buying Life Insurance

- **COMPARING POLICY COSTS**

Compare policy costs which are affected by:

- How selective they are in whom they insure
- Their cost of doing business
- Return on their investments
- Mortality rate among policyholders
- Policy features and competition from other firms

# Buying Life Insurance

- Use interest-adjusted index to compare policies
  - Takes into account the time value of money
  - Helps you make cost comparisons among insurance companies
  - See sites such as [www.accuquote.com](http://www.accuquote.com)

# Buying Life Insurance

- OBTAINING A POLICY
  1. Apply
  2. Provide medical history
  3. Usually no physical for a group policy
  4. Read every word of the contract
  5. After you buy it, you have ten days to change your mind
  6. Give your beneficiaries and lawyer a photocopy

# Buying Life Insurance

## THE “FREE LOOK” RULE

- When you receive your new policy, read it carefully.
- Every new life insurance policy is issued with a 10-day “free look” period. (Some states now provide a longer time period)
- If you are not satisfied for any reason, you may return the new policy within 10 days after you receive it.
- Mail it to the company’s home office or give it back to the agent who sold it to you.
- Be sure to get a dated receipt from the post office or the agent.
- The company must return your premium within 30 days from the date you returned the policy. If the insurance company keeps your money longer, legally it is responsible for a 10 percent penalty—payable to you.

# Life Insurance Proceeds

- Death (or Survivor Benefits)
  - To cover the immediate expenses resulting from the death of the insured
  - To protect dependents against a loss of income resulting from premature death of primary wage earner

# Life Insurance Proceeds

- Common Settlement Options
  - Lump-sum Payment
    - Face amount paid in one installment
  - Proceeds left with the company
    - Pays interest to the beneficiary
  - Limited installment payment
    - In equal installments for a specific number of years after your death
  - Life income option
    - Payments to the beneficiary for life

# Life Insurance Proceeds

- Annuity: Financial contract written by an insurance company that provides you with a regular income
  - Payments may begin at once (immediate annuity) or at some future date (deferred annuity)
- Income from Life Insurance Policies
  - People buy annuities to supplement retirement income and to shelter income from taxes. Annuities are tax-deferred investment plans

# Life Insurance Proceeds

- SWITCHING POLICIES
  - Switch if benefits exceed costs of getting another physical, and paying policy set-up costs
  - The older you are, the higher the premium will be
  - Are you still insurable?
  - Can you get all the provisions you want?