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**Advising the Affluent Client:**

**Insurance Planning**

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## ABOUT GREENE CONSULTING ASSOCIATES, LLC

Greene Consulting Associates was founded in 1979 and provides consulting and training services solely to the financial services marketplace. Located in Atlanta, Georgia, Greene Consulting has worked with the top providers of investment management and wealth management in both the United States and abroad. Focused on helping firms generate incremental revenue growth through more effective sales and relationship management strategies, Greene Consulting offers customized training programs in Financial Services Sales, a Sales Management program, Presentation Training that integrates proprietary products, and a comprehensive suite of online learning courses related to investments and wealth management.

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## Introduction

We all live with certain financial risks associated with our own mortality and human frailty. Death, Disability, and Long-Term Care: these can have a very significant financial impact in our lives, and we need ways to minimize that exposure. Insurance provides a way to manage those risks.

Highly adaptable to individual needs, it is much more a financial planning tool than it is a product. For its proper use, the financial advisors should begin with the human needs under consideration, and then ask if insurance is a viable solution. This is precisely the process that will be presented on the following pages.

Objectives and Course Structure

This course focuses on the financial risks associated with death, disability, and long-term care. Within that context, its objective is to equip you to help clients address their most common insurance planning needs. These are listed on the right.

As each need is presented, guidance will be provided regarding the approach to take with the client. In particular, the course will address how to help the client ***see*** the need and ***desire*** a solution. The methodology for accomplishing this will be addressed on the next page, and then illustrated on the following pages as we address each of the five common insurance planning needs.

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| **Common Insurance Planning Needs**   1. The Need for a Plan with Clear Objectives 2. Identification of Appropriate Types of Coverage 3. Determination of Appropriate Levels of Coverage 4. Coordination of Insurance with Other Financial Planning Decisions 5. Periodic Review of the Plan |

## Helping Clients *See* their Need and *Desire* a Solution

Most people are hesitant in addressing issues associated with their own mortality and frailty. That is why so many people die without ever having executed a will. It is also why people can be slow to address their life-related insurance needs. In fact, it may be even more of an issue when it comes to insurance because it usually requires an ongoing expense for which they may never realize a financial benefit.

This is why it is not sufficient that you alone see the insurable risk in your clients’ lives; they must also see it and must feel motivated to find a solution. This won’t happen simply by informing them that they have an insurable risk for which you have a solution. Your clients will simply thank you for the information and promise to consider it later. Instead, you must guide them to reflect on the risk for themselves; you must get them to open their mind’s eye and confront the consequences that they generally prefer to leave out of sight.

DocumentationIcon_32px**Click the icon to view insight on accomplishing this task.**

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| The best way to accomplish this is to ask questions, not make statements. In this process, avoid asking closed-ended questions that can be answered with a “Yes” or “No.” These questions require no real thought and therefore never get the client to begin contemplating inner feelings and concerns. Rather, ask open-ended questions that cause the client to reflect on his or her current situation. Such questions typically begin with “How” and are process-oriented. They make the client think through the process of resolving the situation you propose. By asking focused open-ended questions, you can assist your clients in reflecting upon the inadequacies of their current planning, or lack thereof, and help them become more motivated to resolve the consequences that they see for themselves.  We are not suggesting that you do this in a manipulative way. Far from it! We are simply pointing out that when it comes to issues like death and disability, no one likes to reflect on these. So, you have a choice. You can skirt around the risk issues you see in your client’s situation and allow your client to continue feeling comfortable; or you can ask some carefully worded questions that might create some momentary discomfort, but are more likely to motivate your client to face their life-related financial risks and seek a solution.   |  | | --- | | Therefore, when you recognize a need for which you can offer a solution, begin asking questions like these:   * How have you planned to provide for the security of your family if you should prematurely die? * How have you planned to ensure that your wife doesn’t have to return to work and place your children in day-care if you should become disabled? * How have you planned so that your wife will have the liquidity she needs to take care of your family, rather than being left with a business she neither knows how to manage nor how to sell? * How have you protected your children’s college savings from being wiped out by the costs of a long-term recovery from an illness or injury? | |

Throughout this course, we will return to this subject of asking awareness questions by providing suggested questions that you can use pertaining to various insurance planning needs.

## Need #1 – The Need for a Plan with Clear Objectives

Insurance purchases are seldom thoughtfully designed and well planned. In fact, most insurance is purchased for reasons of convenience or out of circumstance. For example:

|  |
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| * “My employer offers optional life insurance of five times my annual salary.” * “I can get long-term disability through work.” * “My insurance person recommended that we have enough to pay the mortgage if something happened.” * “Something came in the mail from my association.” |

Although the actual purchases may be somewhat random or disjointed from their financial goals, if asked, clients will nonetheless explain their reasoning in terms that apply to their goals and families:

* “That optional insurance should allow my wife and children to.…”
* “If I get hurt or sick, my husband and kids wouldn’t have to give up the things that are important to them.”
* “If my spouse could pay the mortgage, then it would not be necessary to change my family's lifestyle too much.”
* “That extra insurance from the Elks will take care of the debts we have.”

However, more specifics should be taken into account when creating a high quality risk management plan. You can differentiate yourself by helping clients work through a *process* that accounts for the following issues:

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| **Issues Regarding the Development of Clear Risk Management Objectives**   * Identification of the types of risk the client deems relevant to his or her financial life * Quantified risk needs * Time horizons around those needs * Risk tolerance or concerns around the certainty of payout * Guidelines around the types of coverage and providers that are acceptable * Conditions for changing the portfolio |

Recognizing the importance of having a clear plan and the overwhelming number of individuals who lack one, advisors must be well prepared to uncover this potential need and create a sense of urgency to act. Whenever possible, to avoid embarrassing the client, position the question so that the responsibility for addressing the issue fell on the advisor.

The following are effective questions that will help you accomplish this objective.

DocumentationIcon_32px**Click the icon to view example questions.**

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| **Awareness Questions**   * How did your advisor work with you to establish clearly defined risk management objectives? * How did your advisor help you define how much coverage you actually need given your specific circumstances? * How does your current advisor determine when it’s time to make changes to your insurance portfolio? |

## Need #2 – Identification of Appropriate Types of Coverage

A critical component of assembling an insurance plan is identifying the types of coverage that are appropriate for a given situation. This can be a daunting task because there are so many needs to identify and so many solutions from which to choose. Fortunately, there are patterns of need that tend to change as we go through life. Recognizing this pattern will help provide guidance in identifying insurance needs and identifying appropriate types of coverage. We refer to these changing patterns as the Personal Financial Life Cycle.

This cycle of patterns will be discussed on the following pages to identify solution sets that are most commonly applicable to each stage of the financial life cycle.



## The Personal Financial Lifecycle

People go through three basic cycles in their financial lives. While these three stages tend to be a function of age, that is not always the case. They are more a matter of a person's state of mind and objectives. Likewise, these stages may not necessarily be exclusive to one another, since they quite often overlap.

Think about these stages of financial life as they relate to client needs and objectives. Where individuals are focused regarding their wealth will provide an indicator of the types of needs they will be most interested in resolving. **Click each stage for more information:**



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| **Wealth Transfer**  Once wealth is built, it has a residual value that will be passed on. In this stage, the concern is for the best alternatives to pass money on to heirs.  Although this typically becomes a primary concern for an older person, even a younger person can also be concerned about properly planning for how their wealth will ultimately transfer. |

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| **Wealth Maintenance**  Those who have established their wealth are interested in protecting it. In other words, they want to prevent the possibility of having to lower their standard of living due to a major financial disaster.  That is not to say that the person has necessarily passed beyond wealth accumulation; it could simply mean that they wish to protect what they have while they continue to strive for more. |

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| **Wealth Accumulation**  In this stage, people are trying to build wealth and raise their standard of living. Their overriding concern is for strategies that help them either accumulate wealth or protection for themselves and their family against risks that might prevent them from completing their drive for wealth. |

## The Wealth Accumulation Stage



At each stage of the financial lifecycle, individuals are exposed to various risk factors that can be addressed with various forms of insurance. **Click each factor to learn more.**

|  |
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| **Low Cost, Instantaneous Estate** |
| As clients are seeking to grow and accumulate wealth, they have little disposable income to allocate to insurance. While they have significant risks to be addressed, some simply cannot afford to allocate large percentages of their incomes to insurance premiums. If death occurs in the wealth accumulation stage, there may be insufficient funds to replace lost income or to cover increased expenses associated with the surviving spouse needing assistance with childcare. Thus, there is a need for immediate liquidity that can enhance the size of the estate upon death to provide the necessary funds. |
| **Tax-Deferred Savings** |
| Most people are aware of the advantages of tax-deferred savings in the form of IRAs, 401(k), or 403(b) plans. But such plans are often inadequate, and individuals are in need of alternatives that provide tax-deferred savings. |
| **Income Replacement** |
| One of the greatest risks during the wealth accumulation phase is the loss of the ability to earn money. There needs to be a way to replace income if someone becomes disabled. |
| **Retirement Planning** |
| At this point in the lifecycle, the future is filled with many contingencies. Planning early to minimize the risks of the unexpected can help secure a future with a comfortable retirement. |

## The Wealth Maintenance Stage



To get a better understanding of the needs and objectives of people in the Wealth Maintenance Stage, review each need below. **Click each need to learn more.**

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| **Expense Planning** |
| One of the primary threats to wealth maintenance is sizeable expenses that go beyond the day-to-day expenses. College expenses can certainly cause a drain on financial resources, but at least those are expected and can be planned for through savings. Of greater threat are those expenses that are unexpected. Long-term care for a family member is a significant risk in this regard because the duration of the daily drain on income can significantly threaten the financial security that has been established. |
| **Earnings Replacement** |
| While current earnings may or may not be adding to wealth, they are typically maintaining the day-to-day costs of living so that the accumulated wealth can be preserved. But any loss of earnings, even short-term, could significantly affect savings and jeopardize one's current standard of living. |

## The Wealth Transfer Stage



Review the needs and objectives of people in the Wealth Transfer Stage below. **Click each need to learn more.**

|  |
| --- |
| **Maximize Inheritance** |
| Ideally, people would like to transfer their entire wealth to their chosen heirs, but estate taxes and/or lack of estate liquidity can significantly deplete estate assets. Properly positioned life insurance can provide cash at a critical time to preserve key estate assets. |
| **Minimize Estate Tax Consequences** |
| Estate taxes can often disrupt life-long plans, particularly when the need for liquidity requires the sale of a family business or prized asset. |
| **Charitable Funding** |
| People in this stage also wish to support their favorite charities. Given that charities receive preferential tax treatment, individuals need tools that help them support charities while preserving their estate for heirs as much as possible. |
| **Succession Planning** |
| Sole proprietorships, partnerships, and closely held businesses can have difficulty planning for succession. There is often the need to pre-plan the successor for the protection of the ongoing viability of the company, but the chosen successor may not have the liquidity to buy out the interest of the departing person.  When the departure is due to death, there may be the further complication of a large estate tax bill, where the primary estate asset is the deceased's interest in the business. Failure to properly plan for this contingency could result in an unplanned sale of the business, bringing in outside leadership and possibly diminishing the value of the interest held in the company by other interested parties. |

## Personal Insurance Solutions



For each of these stages, insurance can help manage the risk and provide potential infusion of cash at critical junctures. It can also help them accomplish life goals, such as preserving the value of an estate for children. Listed below are some insurance solutions that may be relevant at each stage of the financial lifecycle. These solutions are discussed in more detail in subsequent training modules. You should be familiar with the basic definition of each and understand how each can be applied to manage the risks and objectives associated with each stage of the financial lifecycle.

Wealth Accumulation Stage

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| **Overview** | **Click each possible Wealth Accumulation insurance solution to learn more.** |
| **Term Life** | The death benefit provides immediate wealth at the death of the insured.  Term Life insurance has no cash value and pays benefits only if death occurs during a stated term of time (typically a year).  Premiums are initially lower than permanent life insurance, making it more affordable for younger people. A state life insurance license is required to sell all types of life insurance.   |  |  | | --- | --- | | **Potentially Appropriate For:**   * Clients with only a temporary need for life insurance * Clients with a permanent need for life insurance but without the current cash flow to pay relatively high permanent life insurance premiums (convertible term life insurance or Universal Life insurance are potential solutions)  |  | | --- | | Convertible term life insurance  ***Convertible term life insurance*** is simply term life insurance that may be converted to permanent life insurance in the future when cash flow may be sufficient to pay higher premiums. | | |
| **Whole Life** | Whole life policies accumulate wealth through the growth of the cash value account during life or a death benefit paid at the insured’s death.  Whole Life insurance provides coverage for the **whole life** of the insured and is characterized by a guaranteed level premium, guaranteed death benefit, and guaranteed cash values.   * Because the life insurance company guarantees the cash values, investments are selected by the insurance company. Investments are generally short- to medium-term fixed income securities with little to no credit risk. * Growth in policy cash values is tax-deferred.   Some policies participate in the profit of the insurance company.   * In such cases, surplus earnings (due to better than projected expenses, investment returns and mortality experience) are returned to the policyholders in the form of non-taxable dividends (not guaranteed). * The dividends can be used in a variety of ways at the election of the policyholder, e.g., to reduce premiums, accumulate interest, purchase additional insurance, etc.   A state life insurance license is required to sell **all types** of life insurance.   |  | | --- | | **Potentially Appropriate For:**   1. Clients who value a premium payment that will not vary 2. Clients with sufficient cash flow to pay fixed premiums 3. Clients who desire a guaranteed interest rate/cash value accumulation 4. Clients who do not wish to manage the investments in their cash value account | |
| **Universal Life** | Universal Life policies accumulate wealth through the growth of the cash value account during life or a death benefit paid at the insured’s death. The insurance company selects the investments in the cash value account.  Universal Life is permanent life insurance and is described by the following features:   * Within limits, the policy owner can adjust the amount of the premiums paid, as well as the premium-paying period. * Within certain underwriting guidelines, the death benefits can be adjusted without requiring issue of a new policy. * Interest on the cash value is tax-deferred and has a guaranteed minimum, but can fluctuate with market conditions. Alternatively, some Universal Life policies offer a guaranteed death benefit for those clients who are not generally interested in policy cash value. * Partial withdrawals can be made from the policy’s cash value without incurring a policy loan (unlike a whole life policy).   Funding a Universal Life policy with flexible premium payments is analogous to keeping enough gas in your car to keep the car running.   * If premium payments are insufficient to maintain the administrative and mortality charges in the policy, the premiums will need to be increased significantly to “catch-up” with current and future charges and/or the death benefit will need to be decreased. * If neither of these adjustments is done or is insufficient, the policy will lapse.   A state life insurance license is required to sell all types of life insurance.   |  | | --- | | **Potentially Appropriate For:**   * Clients with a permanent need for life insurance but with either insufficient current cash flow to pay whole life premiums or significant fluctuations in cash flow * Clients with a need to increase future coverage (e.g., newlyweds anticipating children in 5 years) * Clients who do not wish to manage the investments in their cash value account | |
| **Variable Life** | Variable Life policies accumulate wealth through the growth of the cash value account during life or a death benefit paid at the insured’s death.  Variable Life is permanent life insurance wherein the investment risk is shifted from the insurance company to the owner of the policy.   * Premiums are generally fixed and guaranteed not to increase * The owner can allocate the cash value into funds with different investment objectives, including money market, fixed income, equity, and other choices. * Both the death benefit AND cash value of the policy may fluctuate based on the investment performance of these funds. * Over time, this type of insurance can provide better investment returns than traditional whole life policies and may be a preferred means of tax-deferred savings.   Variable Life policies hold the potential, **but not the guarantee**, of greater wealth accumulation in the cash value account through selection from a menu of different funds.  The Securities and Exchange Commission considers variable life and variable annuity products as securities. Hence, a FINRA securities license, state securities license, and state life insurance license are required to sell Variable Life insurance.   |  | | --- | | FINRA  ***FINRA*** is the Financial Industry Regulatory Authority. |  |  | | --- | | **Potentially Appropriate For:**   * Clients who wish to manage the investments in their cash value account and potentially earn a higher return than in Whole Life or Universal Life policies * Clients comfortable with fixed premiums * Clients willing to accept increased investment risk vs. Whole Life and Universal Life | |
| **Variable Universal Life** | Variable Universal Life (VUL) combines the strengths of Variable Life with those of Universal Life. A VUL policy can be viewed as a Variable Life policy with the ability to adjust the premium payments.  A FINRA securities license, state securities license, and state life insurance license are required to sell Variable Universal Life insurance.   |  | | --- | | **Potentially Appropriate For:**   * Clients with a need to adjust premium payments (e.g., clients with cyclical income streams) * Clients who wish to manage the investments in their cash value account and potentially earn a higher return than in Whole Life or Universal Life policies * Clients willing to accept increased investment risk vs. Whole Life and Universal Life | |
| **Disability** | The greatest source of wealth for many early to mid-career clients may well be their earnings power.  Disability insurance provides income when the insured cannot work due to sickness or injury. The amount of coverage available is usually restricted to 60 to 80 percent of current gross earnings. |
| **First-to-Die** | Life insurance policies may be issued in “individual (single) life” or “joint-life” form. Our discussion of life insurance policies so far has assumed a single life.  First-to-Die insurance is a joint-life policy that pays the death benefit when the first of a small number of insured individuals die. Such policies can be issued as term, whole life, or universal life insurance policies.  These policies offer premiums that may be less than the cost of individual life insurance policies, and can be useful where both spouses work and need protection against loss of income if one spouse dies. These policies are also commonly used to fund buy-sell agreements. |

Wealth Maintenance Stage

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| **Overview** | **Click each possible Wealth Maintenance insurance solution to learn more.** |
| **Whole Life** | Although the cash value accumulates at the relatively low guaranteed rates in the policy, Whole Life insurance policies may have accumulated significant cash value by the maintenance stage. |
| **Universal Life** | Assuming that the insured has paid sufficient premiums, Universal Life insurance policies may have accumulated significant cash value by the maintenance stage. |
| **Variable Life** | Variable Life insurance policies may have accumulated significantly more cash value than Whole Life or Universal Life policies by the maintenance stage.  Remember that the opposite is also possible if the investments have underperformed the guaranteed interest rates in Whole Life and Universal Life. |
| **Variable Universal Life** | Assuming that the insured has paid sufficient premiums, Variable Universal Life insurance policies may have accumulated significant cash value by the maintenance stage. |
| **Disability** | Disability insurance remains critically important for many clients as they seek to maintain and protect their wealth. Loss of income due to sickness or injury poses a serious threat to accumulated wealth during the maintenance stage. |
| **First-to-Die** | First-to-Die insurance should be evaluated for its place in the maintenance stage. Questions to ask include, “do we have the same need for First-to-Die insurance that we had during the wealth accumulation stage?” |
| **Second-to-Die** | Survivorship or Second-to-Die life insurance is a joint-life policy that pays the death benefit when the second of two insured individuals dies.  These policies offer premiums that are less than the cost of two individual life insurance policies and are commonly used to fund estate settlement expenses at the death of a second spouse.  This insurance may be issued as term, but more often it is issued as whole life or universal life insurance policies due to the long-term nature of the risk. |
| **Long-Term Care** | Unmanaged long-term care expenses have the capacity to erode or consume accumulated wealth. Long-Term Care insurance **protects accumulated wealth** by paying a monthly benefit to an insured that requires constant care for a medical condition.  Wise clients will consider this coverage while they are healthy enough to qualify for coverage. |

Wealth Transfer Stage

|  |  |
| --- | --- |
| **Overview** | **Click each possible Wealth Transfer insurance solution to learn more.** |
| **Second-to-Die** | Premiums should generally continue to be paid on Second-to-Die policies until the second death. Properly structured, the death benefit will avoid both income tax and estate tax. |
| **Long-Term Care** | Long-Term Care insurance should be maintained during this stage. The likelihood of long-term care costs increases dramatically with age. |
| **Universal Life** | Assuming that the insured has paid sufficient premiums, Universal Life insurance policies should have accumulated even more cash value since the maintenance stage. |
| **Whole Life** | Whole Life insurance policies may now be approaching “paid up” status depending upon the policy’s structure. A policy is paid up when premiums are no longer required in order to maintain the death benefit protection. |
| **Insurance Policies for Funding a Buy-Sell Agreement** | This is an agreement where one or more parties agree to purchase the business interest of a person upon his/her death and the liquidity for that purchase is provided for by the purchase of an insurance policy on the life of that person.  This may be accomplished by one or more individuals purchasing insurance policies (for example, several partners might purchase policies on each other) or by having the business purchase the policy. |

## Review Exercise

**Answer the following true/false questions by clicking your choice of answer.**

1. **Life insurance policies’ cash values grow on a tax-deferred basis.**

* True
* False

1. **The sale of all life insurance policies requires a state life insurance license at a minimum.**

* True
* False

1. **Variable policies are considered securities and may only be sold by those individuals holding both a FINRA and state securities license.**

* True
* False

1. **Because it insures the lives of 2 people, second-to-die coverage is usually MORE expensive than individual coverage on two people.**

* True
* False

1. **Term insurance has no cash value.**

* True
* False

1. **First-to-Die life insurance is typically more appropriate for younger couples than Second-to-Die.**

* True
* False

The answers to these questions are found on the following page.

## Review Exercise – Answer Key

**Answer the following true/false questions.**

1. **Life insurance policies’ cash values grow on a tax-deferred basis.**

* **True**

**Correct**.

* False

**Incorrect.** Cash values of an insurance policy do grow on a tax-deferred basis.

1. **The sale of all life insurance policies requires a state life insurance license at a minimum.**

* **True**

**Correct**.

* False

**Incorrect**.

1. **Variable policies are considered securities and may only be sold by those individuals holding both a FINRA and state securities license.**

* **True**

**Correct**.

* False

**Incorrect**. Only FINRA and State securities licensed individuals can sell a variable product

1. **Because it insures the lives of 2 people, second-to-die coverage is usually MORE expensive than individual coverage on two people.**

* True

**Incorrect**. Because in a second-to-die policy, two people must die before the death proceeds are paid. The insurer has deferred and reduced the risk compared to issuing two policies on two individuals. Two individual policies will pay a death benefit at the first and the second death. Therefore, the premium on two people in a second-to-die policy is less expensive than two policies on two people.

* **False**

**Correct**.

1. **Term insurance has no cash value.**

* **True**

**Correct**.

* False

**Incorrect**.

1. **First-to-Die life insurance is typically more appropriate for younger couples than Second-to-Die.**

* **True**

**Correct**.

* False

**Incorrect**.

## Understanding Insurance Products

Having gained some insight into the financial lifecycle, the objectives and needs that are common in each stage of the lifecycle, and the insurance solutions that are relevant to them, we now turn to a more in-depth analysis of the insurance products that are used to deliver those solutions. We will begin by exploring the various types of life insurance that are available and some of the features that can be tailored to meet specific situations. This will be followed by a study of disability and long-term care insurance.

## The Two Types of Life Insurance

There are two basic types of life insurance: Term Life and Permanent Life. **Click each type to learn more.**

|  |
| --- |
| **Term Life Insurance** |
| Provides a death benefit only and exists for a specific time period. |
| **Permanent Life Insurance** |
| Provides a lifetime death benefit and may provide a savings element that is reflected as "cash value". |

We will detail each of these insurance structures on the following pages.

## Term Life Insurance

Term life insurance has **no cash value** and offers **no savings or investment benefit**. But it does provide a **death benefit** if death occurs during a stated period of time (typically a year). That makes it the most basic and least expensive type of life insurance available. Term life insurance is usually issued in one of the forms listed below. **Click each form to learn more.**

|  |
| --- |
| **Renewable Term** |
| Term insurance can be underwritten to be *renewable*, or not renewable, at the end of the initial "term period," e.g., at the end of five years. It may be renewable conditionally, based on the health status and insurability of the insured, or guaranteed renewable, regardless of the health status or insurability of the insured.  Some policies will have two sets of guaranteed renewable rates: one for those who provide new evidence of insurability at each renewal date, and a higher schedule of rates for those who do not (or cannot). In either case, the premiums will increase at each renewal period as the insured gets older. Term policies are often renewable to about age 70, although many policies are renewable to about age 100. Including the right to renew a term policy increases the cost of coverage. |
| **Convertible Term** |
| A term policy may or may not include the right to ***convert*** the term policy to a "permanent" or whole life policy without evidence of insurability. The right to convert is usually limited by a period of years or prior to a certain age. Including the right to convert a term policy increases the cost of coverage. |
| **Level, Decreasing, or Increasing Term** |
| The vast majority of term insurance written is ***level term***; this means that the death benefit remains the same throughout the term of the policy. The premium is level throughout the term. ***Decreasing term*** policies have a scheduled decrease in the death benefit and are occasionally used to provide coverage for loans and mortgages. The premium is level throughout the term. Increasing term policies, where the death benefit increases throughout the term, are underwritten by just a few companies and have an increasing death benefit and premium throughout the term. |
| **Inexpensive Short-Term** |
| The initial premiums of term life insurance are generally less than those of permanent life insurance. That makes it more affordable for younger clients with limited funds. It also makes it the better choice when the need for life insurance is for a short, limited time, as might be the case when required to have term insurance before receiving approval on a loan. |
| **Expensive Long-Term** |
| But over time, term insurance premiums typically increase as the policy is renewed for the same amount of coverage. Permanent insurance is issued with a level premium that is higher than term insurance when issued at a given age, but becomes less expensive than term insurance as the insured ages.  Thus, the appeal of low initial premiums must be balanced against the fact that premiums of term life insurance will be higher in later years. Where the need for life insurance is long-term, total cost of insurance may be less with permanent insurance. It is also important to keep in mind that one's insurability might decline over the years, and coverage might eventually be lost with term insurance when it could have been retained with permanent insurance. |

## Permanent Life Insurance

In contrast to term life insurance, Permanent Life insurance offers two key benefits:

* **Lifetime coverage** - Not just for a specified term.
* **Cash Surrender Value (CSV)** - Supplements life insurance coverage by accumulating the invested funds (less fees and expenses) as a cash value. If the policy owner chooses to terminate the policy at any point, it should be noted that the CSV would be less than the premium payments put into the policy.

Types of Permanent Life Insurance

Policy owners have the greatest selection of policy types as a result of the evolution of these policies to meet needs for more flexibility of premium payments as well as a desire to direct the investment allocation of policy cash values. This has resulted in a variety of new policy designs to supplement Traditional Whole Life. The four most popular types of Permanent Life insurance are listed below: **Click each term to learn more.**

* Traditional Whole Life
* Universal Life
* Variable Life
* Variable Universal Life

While there are certainly variations of these types, with some policies combining elements of more than one type, all Permanent Life policies essentially are contained within these four types. The following pages will discuss each of them in some detail.

## Traditional Whole Life Insurance

With Traditional Whole Life insurance, the **insurer assumes all the investment risk**. Premiums are fixed and guaranteed upon purchase of the policy, although they may be structured any one of the following ways listed below. **Click each structure to learn more.**

|  |
| --- |
| **Single-premium** |
| A single premium policy is payable in a single, lump-sum premium. Since it is fully "**paid up**" upon purchase, it has the highest cash value at any point in time of any Whole Life policy.  Be aware that single premium policies may create unwanted income tax consequences as a result of the Modified Endowment Contract rules.   |  |  | | --- | --- | | A Modified Endowment Contract ***(MEC)*** is one wherein the premiums paid into the policy during the first seven years exceed certain limits. If a policy is classified as a MEC, the income tax treatment of any death benefit provided under the contract will still qualify for federal income tax-free treatment, but the owner may be subject to additional income taxes and penalties on any distributions from the policy during the life of the insured.   |  | | --- | | Certain Limits  To prevent Permanent Life insurance policies from being used more for investment purposes than for the insurance protection they provide, the Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982 created what is known as the ***TEFRA Corridor***. This act imposed limits on the cash value allowed in Permanent Life insurance policies during the first seven years of the policy, requiring that it could not exceed a specified percentage of the policy's face amount. The specific limitation depends upon the insured's age.  If the cash value exceeds these limits, then the policy is treated strictly as an investment account and taxed accordingly. As a result, insurers will not allow the cash in the account to exceed these limits. In fact, most policies will state that if cash value does exceed these percentages, then the face amount will automatically increase to stay within the TEFRA corridor. | | |
| **Continuous premium** |
| Also known as **Straight Life**, this premium is generally payable until death or age 95 to 100. |
| **Limited-payment** |
| Premiums cease at the end of a stated number of years or upon the insured reaching a specified age. When premiums end, the policy remains in force and is considered "**paid-up**". The sooner it is paid up, the greater its cash value at any point in time. Limited-pay funding of a life insurance policy during the first 7 years may cause the policy to be classified as a Modified Endowment Contract as discussed previously. |
| **Modified-premium** |
| Annual premiums change after specified periods of time, e.g., 5, 10, 15, or 20 years. This can allow for lower premiums in the earlier years, while keeping the face amount level. |

DocumentationIcon_32px**Click the icon to learn about Cash Value (Cash Surrender Value)**

|  |
| --- |
| **Whole life policies also accumulate cash value, which is often referred to as cash surrender value or CSV. This is the amount that would be received, less any surrender costs, if the policy were cashed in. It is also the amount against which loans can be obtained. Everything else being equal, the rate at which the cash value builds is a function of the** amount and timing of premiums paid**. For example, a single-premium policy or limited-payment policy will have a greater cash value at any point in time than will a continuous premium or modified-premium policy.**  **Do not confuse cash value with the face amount, which is the amount of coverage that is payable upon death. This coverage is referred to as "face amount" because it is usually stated on the face of the policy.**  **Cash value will increase over time, typically reaching the face amount at age 99 or 100** (or in recent years of issue up to age 120 or 125). Once it reaches the face amount, or “endows,” the life insurance policy terminates and is paid out in lump sum or, at the election of the policy owner, as a settlement option. |

## Modifications to Traditional Whole Life Insurance

While most people purchase life insurance for a set amount on one individual, an alternative known as ***modified amount coverage*** is also possible. Recognizing that as people age their need for life insurance typically decreases, this alternative will modify the amount of coverage downward as the insured ages. Since coverage decreases over time, premiums are less, making this type of coverage more affordable.

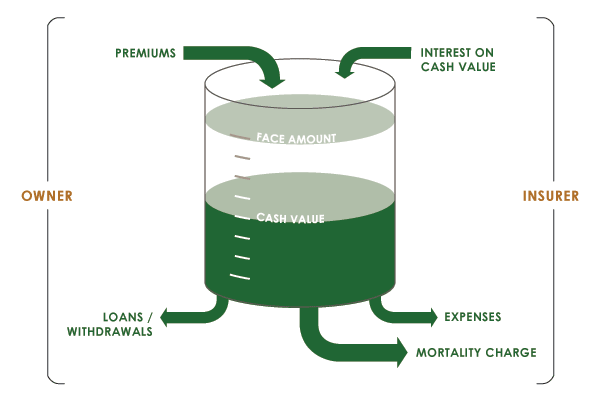
|  |
| --- |
| **Reaping the Benefits of Favorable Markets**  To meet demand for sharing in the benefit of an investment windfall, **Interest-Sensitive Whole Life Insurance**, also known as **“Current Assumption Whole Life Insurance,”** was developed.  Such policies allow the premium rate to change if assumptions regarding mortality should change or if investment return or expenses are different than what was projected. Alternatively, if investment return is greater than was expected or expenses less, then premiums can be held constant and cash value will become greater than the guaranteed amount.  In short, such policies result in a limited sharing in the risk and potential return of the market's and insurer's performance, and somewhat bridge the gap between traditional whole life policies and more recent policies that provide greater opportunity for enhanced return. |

## Universal Life Insurance

Universal Life Insurance was developed to respond to increased demand for financial products that offered more flexibility than standard Whole Life contracts.

Unbundled Pricing and Flexible Premiums

Unlike the Traditional Whole Life insurance, the various pricing factors of a Universal policy (mortality charge, expenses, interest) are unbundled and stated independently of each other. To understand how this operates, think of an empty tank into which the policy owner pours the premium payments. Various cash flows go into or out of the tank, some involving the owner, others involving the insurer. Whatever remains in the tank at any point in time is the cash value of the policy. **To learn more, click each term in the diagram.**



|  |
| --- |
| **Premiums**  Within limits, the policy owner can choose the size of the initial premium and vary the amount and the timing of subsequent premium payments. As long as the cash value of the policy is sufficient to pay the periodic charges (e.g., mortality charges and administrative fees) made by the insurer, the policy will stay in force, even if no premium payments are made. And if the owner elects to increase the size of the premiums, the cash value (the balance in the tank) will be higher.  If the premiums are ever insufficient to keep the policy in force, the owner is usually given a notice that the policy will lapse if additional funds are not received within a period of time, typically 60 days. |

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| **Interest on Cash Value**  The policy guarantees that the insurer will pay a minimum interest rate on the cash value, with payments usually made to the account monthly. Market conditions may allow for an even higher rate to be paid. |

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| **Loans/Withdrawals**  Just as with Traditional Whole Life insurance, since the policy has cash value it is possible to make loans against the policy. But with the universal policy, it is also possible to make withdrawals directly from the cash balance. |

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| **Mortality Charge**  This is the charge that is periodically deducted (usually monthly) from the cash value of the account to pay for the life insurance coverage. The amount is based on the insured's current mortality risk, and will typically increase each year, although the policy will limit the amount by which it may increase. |

|  |
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| **Expenses**  Various other expenses will also be charged against the cash value. These charges include a flat charge to cover sale and issuance of the policy, a percentage of the annual premium to cover expenses (e.g., 5%), a monthly administration fee, special service fees for cash withdrawals, etc. |

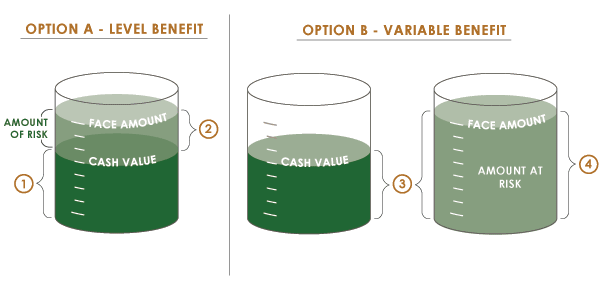
## Universal Life Insurance (Continued)

Flexible Face Amount

Within limits, the policy owner can determine the face amount of the policy upon issue. After a period of time, the owner may request to change the face amount, but a request for an increase typically must be accompanied by evidence of continued insurability. Interestingly enough, the request for a decrease in coverage will also require the insurer's approval to make sure that the cash value is not so great in comparison to the face amount of the policy that it would lose its status as an insurance product and instead become an investment product, thereby losing the tax deferral aspect of the contract.

Flexible Benefit

At the time of purchase, the owner also decides if the death benefit will be level or will vary with the changes in the cash value. To understand the significance of these choices, refer to the diagrams below. **Click each number to learn more.**



|  |
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| **1 – Level Benefit Amount**  The total benefit amount is fixed and equal to the policy's face amount. At the time of death, the benefit payment will consist of the cash value remaining in the account plus whatever mortality benefit is needed to reach the face amount.  **Level Benefit Amount = Face Amount** |

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| **2 – Mortality Cost**  The Mortality Charge is based upon the net amount at risk to the insurer. The amount at risk is the portion the insurer will need to provide in excess of the cash value.  **Net Amount at Risk = Face Amount - Cash Value**  Thus the greater the cash value, the less the amount that must be insured and the lower the mortality charge. Therefore, if the owner elects to make large premium payments, the cost for the insurance coverage will decrease. |

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| **3- Variable Benefit Amount**  Here, insurance coverage is provided for the full face amount, independently of the cash value. Thus the total benefit that is paid out at death is the face amount plus the cash value. In other words, the total benefit is allowed to vary from the face amount in direct relation to the cash value.  **Variable Benefit Amount = Face Amount + Cash Value** |

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| **4 – Variable Benefit Mortality Cost**  Here, the cash value does not reduce the amount at risk, thus a mortality charge must be assessed against the full face value. Obviously, this will result in higher premiums than the level benefit option.  **Net Amount at Risk = Face Amount** |

## Investment Return in Universal Policies

Because the purchaser of a Universal policy bears some of the interest rate risk, Universal policies are typically less expensive than Whole Life coverage and the interest rate is typically higher. Should market rates increase significantly, the rate in the Universal policy might also increase, making it possible to reduce the premium payments. Of course, premiums could also increase if rates decline.

It is also worth noting that a return within an insurance policy is tax-deferred. This can make a Universal policy appealing. And as shown in the preceding illustration, it is possible to have a sizeable amount of funds earning tax-deferred interest.

Note that Universal Life insurance policies are subject to the Modified Endowment Contract limits discussed previously.

## Variable Life Insurance

The Variable Life insurance policy goes one step further by ***allowing the purchaser to completely assume the investment risk***. Rather than placing premiums in the insurer's general funds, premiums of a Variable Life policy are placed in separate investment accounts, called ***separate accounts***. These separate accounts allow the owner to control the investments of the fund and present the owner with a number of investment options that are typically available only through mutual funds. A typical combination of accounts would include at least one money market fund, bond fund, and equity fund. The purchaser is allowed to allocate the premiums among those funds, and can periodically reallocate the mix.

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| **Who Can Sell Variable Policies**  Because the purchaser assumes all the investment risk, Variable policies must be registered with the Securities & Exchange Commission (SEC) and can only be sold by those holding both FINRA and state securities licenses, such as licensed broker/dealers. Potential purchasers must also be presented with a prospectus at or prior to the initial sales call.  This prospectus will outline the expenses of the policy, the investment options, their investment objectives, and past performance, as well as the benefit provisions, surrender charges, the policy owner's rights, and other important details regarding the policy structure. |

**The death benefit AND cash value of these policies are allowed to vary**, reflecting the investment performance of the underlying investment funds. Most policies will guarantee that the face amount will never go below a certain level; but they will not guarantee investment earnings, nor will they guarantee a minimum cash value.

Note that Variable Life insurance policies are subject to the Modified Endowment Contract limits discussed previously.

## Variable Universal Life Insurance

This type of insurance provides the features of both Variable and Universal Life insurance. Like Universal Life, the owner can choose the following (within limits):

* The premium amount
* The face amount
* Typically, the type of death benefit (fixed or variable)

But like Variable Life, any cash value is placed in a separate investment account(s) and the owner assumes all the investment risk. Also like Variable Life, only those holding both FINRA and state securities licenses, such as licensed broker/dealers, may sell these policies.

Note that Variable Universal Life insurance policies are subject to the Modified Endowment Contract limits discussed previously.

## Coverage Options

Having looked at the different types of permanent insurance, let's now look at some of the coverage options available, other than those on a single life. **Click each type of coverage to learn more.**

|  |
| --- |
| **First-to-Die** |
| This is a joint-life policy that pays the death benefit when the first of a small number of insured individuals die. These policies offer premiums that are less than the cost of individual life insurance policies, and can be useful where both spouses work and need protection against loss of income if one spouse dies. These policies are also commonly used to fund buy-sell agreements. This insurance is issued as term, Whole Life or Universal Life insurance policies. |
| **Survivorship or Second-to-Die** |
| This is a joint-life policy that pays the death benefit when the second of two insured individuals dies. These policies offer premiums that are less than the cost of two individual life insurance policies and are commonly used to fund estate settlement expenses at the death of a second spouse. This insurance may be issued as term, but more often as Whole Life or Universal Life insurance policies due to the long-term nature of the risk. |

## Common Riders

Riders are attachments to policies that add additional benefits. While they may add to the cost of the policy, they do provide flexibility in adapting coverage to meet individual needs. This makes it possible to make later adaptations without having to redo the entire policy. They can also place limits on the exposure of the insurer.

The following are some of the more common benefits that are seen in riders. **Click each type of coverage to learn more.**

|  |
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| **Accelerated Death Benefits** |
| These riders make it possible to receive a portion of the death benefits if you become terminally ill or suffer a serious medical condition. These benefits are exempt from Federal income taxes. Some insurers will also waive future premiums once the benefits begin. Of course, any receipt of benefits while alive will reduce the ultimate death benefit.  These benefits have become increasingly popular in recent years, particularly with the onset of AIDS. They are typically triggered by one of the following events:   * **Dread Disease or Catastrophic Illness** - Where the insured has contracted one of the dread diseases listed in the policy, e.g. cancer. * **Long-Term or Chronic Care** - Where the insured cannot perform routine activities of daily living and requires ongoing care in a nursing home or at home. The Health Insurance Portability and Accountability Act has defined these activities as: eating, toileting, transferring, bathing, dressing, and continence. Many insurers have since adopted this list. * **Terminal Illness** - Where death is expected to occur within the time period established by the policy, typically less than one year. According to one study, the vast majority of accelerated death claims are for this purpose.   For policies that do not provide these services, one possibility for raising cash when faced with a terminal illness is a ***viatical*** settlement. In a viatical settlement, the policy on an insured person who only has a year or two to live is purchased as an investment. There has been significant growth of the viatical industry in recent years, increasing the opportunities for such a settlement. |
| **Accident Benefits** |
| These are additional benefits that are paid for accidents. This is triggered in one of two ways:   * **Accidental Death** - Pays an additional amount beyond the face amount if the insured's death is due to an accident. It is referred to as a ***double indemnity*** benefit if the accidental death benefit is equal to the face amount. There are some typical exclusions, e.g. war, suicide, and illegal activities. The coverage usually lapses once the insured reaches age 65 or 70. * **Dismemberment** - Provides additional benefit if the insured has an accident in which he or she loses any two limbs, or the sight in both eyes, etc. Typically, riders combine this with accidental death coverage, but will not pay both if the same accident results in death and dismemberment. |
| **Guaranteed Insurability Benefit** |
| This rider gives the insured the right to purchase additional insurance of the same type without having to provide evidence of insurability. There are typically specified option dates and limits as to the amount of additional insurance that can be purchased. |
| **Supplemental Disability Benefits** |
| Such benefits either waive the premiums or provide income in case of disability. They generally have a waiting period before benefits begin and typically expire once the insured reaches retirement age. They can usually be seen in one of three types of riders.   * **Waiver of Premium for Disability** - Where the insurer pays the premiums on behalf of the insured ***while the insured is disabled***. Note that since the insurer continues paying the premiums, the policy continues to build cash value. * **Waiver of Premium for Payor** - Here, the premiums are waived if the owner dies or becomes disabled. This is typically used when the insured is a minor, and the waiver usually lapses once the insured reaches age 18 or 21. * **Disability Income** - Provides a recurring income benefit to the insured in the event of total disability. |

## Review Exercise

Beside each of the policies listed below is a number. That number identifies how many of the features listed to the right are descriptive of that particular type of policy. **Click those features you believe correspond to each policy type. You will receive a blue check for each correct response and a red X for each incorrect response.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Cash Value** | **Lifetime Coverage** | **Death Benefit** | **Permanent Insurance** | **Separate Investment Accounts** | **No Investment Risk for Insured** | **Prospectus Required for Sales** |
| **Variable Life (6)** |  |  |  |  |  |  |  |
| **Whole Life (5)** |  |  |  |  |  |  |  |
| **Term Life (2)** |  |  |  |  |  |  |  |
| **Universal Life (4)** |  |  |  |  |  |  |  |

**Indicate whether or not the following questions are true or false by clicking your responses.**

1. **The cash value of term insurance is always less than that of permanent insurance.**

* True
* False

1. **The face amount of a policy is its cash surrender value.**

* True
* False

1. **The TEFRA Corridor imposes limits on the cash value allowed in a universal policy.**

* True
* False

1. **As long as the policy owner pays sufficient premiums to maintain enough cash value to pay the policy’s mortality charges and expenses, the owner of a universal policy has the flexibility to pay premiums whenever he or she desires.**

* True
* False

The answers to these questions are found on the following page.

## Review Exercise – Answer Key

Beside each of the policies listed below is a number. That number identifies how many of the features listed to the right are descriptive of that particular type of policy. **Click those features you believe correspond to each policy type. You will receive a blue check for each correct response and a red X for each incorrect response.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Cash Value** | **Lifetime Coverage** | **Death Benefit** | **Permanent Insurance** | **Separate Investment Accounts** | **No Investment Risk for Insured** | **Prospectus Required for Sales** |
| **Variable Life (6)** | check_checked | check_checked | check_checked | check_checked | check_checked | red_x | check_checked |
| **Whole Life (5)** | check_checked | check_checked | check_checked | check_checked | red_x | check_checked | red_x |
| **Term Life (2)** | red_x | red_x | check_checked | red_x | red_x | check_checked | red_x |
| **Universal Life (4)** | check_checked | check_checked | check_checked | check_checked | red_x | red_x | red_x |

**Indicate whether or not the following questions are true or false by clicking your responses:**

1. **The cash value of term insurance is always less than that of permanent insurance.**

* **True**

**Correct**! Term insurance does not have cash value, so in comparing it to permanent insurance, which will build cash value, it is by definition going to have “less” cash value than permanent policies.

* False

**Incorrect**.

1. **The face amount of a policy is its cash surrender value.**

* True

**Incorrect**.

* **False**

**Correct**! The face amount is the amount of coverage.

1. **The TEFRA Corridor imposes limits on the cash value allowed in a universal policy.**

* **True**

**Correct**!

* False

**Incorrect**. This is the definition of the TEFRA Corridor.

1. **As long as the policy owner pays sufficient premiums to maintain enough cash value to pay the policy’s mortality charges and expenses, the owner of a universal policy has the flexibility to pay premiums whenever he or she desires.**

* **True**

**Correct**!

* False

**Incorrect**.

## Disability Insurance

Disability insurance is another important type of insurance. As the name implies, disability insurance is designed to provide income replacement for wage earners in case they become injured or otherwise unable to work. While simple in definition, there are many variations of disability insurance that you need to be familiar with. The coming pages address the important aspects of disability insurance that will make you conversant and capable of discussing this coverage with clients.

* Primary types of policies
* Determining and understanding the “definition of disability”
* Typical coverage limits
* How benefits are calculated
* Benefit limits
* Taxability of benefits
* Elimination Period and duration of benefits
* Indexing of premiums and benefits

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Primary Policy Types**  There are three primary types of disability policies. **Click each type to learn more.**   |  | | --- | | **Sick Leave Plans** | | These plans provide protection against lost income and wages for the insured during short-term periods when they are sick or injured and unable to work. | | **Short-term Disability Plans** | | Short-term disability plans cover the insured for limited periods of time when they are disabled. Typically, these plans provide some degree of income replacement for 3 to 6 months. They begin paying benefits after a short period of disability, sometimes as few as 8 days. | | **Long-term Disability Plans** | | Long-term disability plans are designed to provide coverage for insured persons when they are disabled for long periods of time, or even permanently. Usually, these policies begin to pay benefits after 90 consecutive days of disability and pay for extended periods of time, sometimes up to the retirement age of 65 years old. | |

## What Defines “Disability”?

Is a professional baseball player earning $3,000,000 per year functionally disabled if he injures his knee sliding into third and can no longer play major league ball? That depends on the definition of disability in his policy. While he may no longer be able to play major league baseball, he can still earn a living as a business executive. This illustrates why the specific definition contained in the policy is a very important issue to understand when dealing with disability insurance.

|  |  |
| --- | --- |
| **Overview** | The three primary types of disability definitions are listed on the left. **Click each definition to learn more.** |
| **Any Occupation**  **("Any Occ")** | Policies with this definition provide coverage when the insured is disabled to the point that he or she can no longer work in ***any occupation***. This type of coverage would be meaningless for the professional baseball player. Despite the loss of his professional career, he can still be gainfully employed as a fast food worker or greeter in a retail store. |
| **Reasonable Occupation (“Reasonable Occ”)** | This definition is more favorable to the disabled worker than the “Any Occ” definition and less favorable than the “Own Occ” definition.  If one is unable to perform an occupation for which one is **reasonably suited by training, experience, or education,** then one is disabled under the “Reasonable Occ” standard.  A professional baseball player with a career-ending knee injury would not be considered disabled under this standard if he could coach or train other athletes. |
| **Own Occupation**  **(“Own Occ”)** | This is the most favorable definition to the insured. As one might expect, it is also the most expensive coverage.  **“Own occupation” coverage replaces income when the insured is no longer able to perform in his or her current occupation.**  Surgeons or dentists are examples of persons who might need this type of coverage, as would the professional baseball player.   * For example, should any of these persons be in an accident where they lose a hand, they could no longer perform their current duties. * Neither the “Any Occ” nor the “Reasonable Occ” definition would cover their disability since they could still earn a living as a greeter or as a coach, but an “own occupation” policy would.   This coverage is frequently issued for the highest paid occupational classes, and consequently has the highest premiums relative to other types of policies. |

## Taxation of Benefits

While the taxation of disability benefits can become complex, the general rule is: ***whenever an individual pays premiums on an after-tax basis, the benefits will be tax-exempt.***

One complication to note, however, comes into play with Social Security Disability Income (SSDI) benefits. Under Social Security, disabled workers have access to some disability coverage, albeit very limited. These benefits are not taxable until the client meets certain thresholds of income. Most affluent clients will typically have their SSDI treated as taxable income.

***Noteworthy*** - Your client should be very cautious in relying upon SSDI to manage disability risk. SSDI uses the “any occupation” definition of disability and benefit amounts are relatively small.

## Other Key Disability Terms to Understand

There are a few other important terms related to disability insurance that need to be understood. **Click each term to learn more.**

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| --- |
| **Elimination Period** |
| The “Elimination Period” is the period of time when the insured is considered disabled, yet still unable to collect benefits. It is similar to the deductible for auto insurance. The most common elimination period for disability policies is 90 days. |
| **Indexing of premiums and benefits** |
| In some cases, the policy may provide indexing of benefits for inflation. This is a valuable feature, as it provides inflation protection for the beneficiary in case of long-term disability. |
| **Benefit Duration** |
| Disability policies are designed to provide income protection in the event of disability. They are not designed to provide a lifetime annuity to the insured. Therefore, long-term disability policies typically provide coverage until age 65, when a person would normally be expected to retire. In contrast, short-term policies may only provide protection for up to a few months.  It is, therefore, important to identify the scope of coverage a wage earner needs and the amount of potential income replacement available to them should they become disabled. If the disability coverage provides only short-term benefits, the lost income for longer periods must be made up through other means. |

## Long-Term Care

Having discussed disability insurance, we now turn our attention to long-term care insurance. ***Long-term care*** (LTC) refers to the medical and custodial services used by Americans who have disabilities or chronic illnesses. These services involve very personal care, but they can also include the skilled care of a doctor, nurse, or physical therapist. Because of the personal service nature of long-term care, the costs are not picked up by most commercial group health care or individual health care plans.

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| **Benefit Amounts**  Benefits for long-term care insurance should be thought of in terms of “daily” and “maximum” amounts. Two common options available are:   * Daily benefits of $50, $100, $150, $200 or more paid out over a maximum of two, three, or six years, or over the insured’s lifetime. In some policies, the daily benefit and benefit period may also be multiplied to determine a maximum lifetime benefit, which is more attractive when benefits received are less than the daily benefit such as in limited assisted living care. * A “per diem” policy that pays out a lifetime maximum benefit, such as $150 daily and a $350,000 lifetime limit. Sometimes these policies will pay a flat amount per day regardless of the costs incurred.   These amounts are applied to the cost of care for the insured. On the following pages, we will look at the different types of care that are available. |

Medicare, Medicaid, and Long-Term Care

Long-term care is sometimes confused with Medicare and Medicaid, which are government programs. **Click on each below to learn more.**

|  |
| --- |
| **Medicare** |
| ***Medicare*** is the federal health care program for individuals age 65 or older, or individuals with certain disabilities or illnesses. It is divided into several parts:   * Part A covers inpatient hospital, skilled nursing facility, home health, and hospice care. * Part B covers reasonable and necessary medical services such as doctors’ services, outpatient hospital care, home health care, and medical supplies, among other things. * Part C is referred to as “Medicare Advantage Plan” coverage and combines commercial health insurance coverage with Medicare Part A and Part B coverage. * Part D covers outpatient prescription drugs.   ***Noteworthy – Medicare does NOT pay for long-term care costs!*** |
| **Medicaid** |
| ***Medicaid*** serves very low-income people of every age. Medicaid patients receive a wide range of medical care, including long-term care, at no or reduced cost. Medicaid is funded by federal, state, and local tax funds.  ***Noteworthy – Unless an individual is extremely poor, he or she will not generally qualify for Medicaid coverage.*** |

Eligibility for Long-Term Care

There are two approaches to determining when a client is eligible to receive benefits from a long-term care policy: inability to perform the activities of daily living and cognitive impairment. **Click each approach to learn more.**

|  |
| --- |
| **Activities of Daily Living (ADLs)** |
| Eligibility for long-term care is often regulated by the number of ADLs that are violated. Benefits are paid if the insured cannot perform a certain number (depends on the policy) of these functions. Required ADLs usually include:   * Eating * Dressing * Bathing * Transferring (e.g., moving from bed to chair) * Toileting * Continence * Grooming/personal hygiene * Walking/ambulating * Mobility inside the home   Typically,a licensed health care practitioner must certify that the need for assistance with the ADLs is reasonably expected to continue for at least 90 days. |
| **Cognitive Impairment** |
| Cognitive impairment involves the deterioration or loss in intellectual capacity causing impairment in some or all of the following:   * Short- and long-term memory loss * Loss of orientation to people, places, and time, * Loss of deductive or abstract reasoning (including judgment)   Deficiencies in cognitive function are reflected in inability to perform certain instrumental activities of daily living (IADLs) which typically include the following:   * Shopping for personal items * Managing money * Using the telephone * Preparing meals * Managing medication * Doing housework   Benefits payable upon activation of cognitive impairment begins when the individual has been certified to require substantial supervision to protect himself or herself from threats to health and safety due to cognitive impairment. |

## Types of Long-Term Care

Most policies will allow the insured to apply their benefits to various services. The table below describes some of the more popular types of care available. **Scroll through the document to view the types of available care.**

|  |  |
| --- | --- |
| **Types of Long-Term Care** | |
| **Skilled Nursing Care** | This is intended for those who must be “under the supervision of a physician.” Care is provided by doctors, nurses, and other skilled medical personnel 24 hours a day. |
| **Custodial Care** | Also known as personal care, *custodial care* consists of helping in the carrying out of the ADLs. |
| **Intermediate Nursing Care** | *Intermediate nursing care* is requested by the attending physician and supervised by registered nurses. It is less specialized than skilled nursing care, involves more custodial care, and is not 24-hour service. |
| **Home Health Care** | Some LTC policies pay a daily benefit for a person to come into the home and cook meals, run errands, ensure medications are taken, and assist with any necessary ADLs. |
| **Assisted Living Care** | Assisted living is for individuals, generally senior citizens, who can live independently, but still need assistance performing certain ADLs. |
| **Adult Day Care** | Adult day care services are community programs designed to meet the needs of functionally and cognitively impaired adults. Adult day centers generally operate during normal business hours five days per week. Normally, people will drop their parents off in the morning and pick them up after work, as they would with child day care centers. |
| **Respite Care** | Respite care provides a break for family members taking care of their elder relatives. This is temporary care while the family takes a vacation or simply takes a few days off from caring for the individual. |

## Other Characteristics of Long-Term Care

There are several characteristics of long-term care insurance that are generally applicable no matter what type of policy is purchased. **Click on each to learn more.**

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| **Elimination Period** |
| An ***elimination period*** is a waiting period during which time LTC benefits are not paid. In LTC coverages, the elimination periods can range from zero to 365 days. The shorter the elimination period, the higher the premiums will likely be.   * **Waiver of Premium:** Stipulations for qualification and benefits vary by company and policy. Definitions of waiting period, “disability,” length of premium waiver and whether the waiver applies to a surviving spouse can all vary * **Shared Care:** Policies can be written to share the LTC benefits with a spouse from a joint pool of benefits. |
| **Renewability** |
| * **Guaranteed Renewable:** Virtually all policies written today are guaranteed renewable as long as premiums are paid (reinstatement provisions are more liberal than life and other types of health insurance). Premiums are rarely guaranteed. * **Optionally Renewable:** The insurer may cancel the coverage for any reason with appropriate notice. |
| **Inflation** |
| Long-term care expenses may occur a decade or more after a policy is purchased. A benefit indexed to inflation is a virtual necessity in an effective long-term care policy. |
| **Exclusions** |
| ***Exclusions*** for long-term care policies will often include self-inflicted injuries and treatment specifically provided for detoxification or rehabilitation of alcoholism or drug abuse. |
| **Underwriting** |
| Factors affecting the terms of issue and pricing of LTCI include the following:   * Age * Marital Status (more favorable if married. Also spousal discounts usually offered). * Medical conditions (note that an LTC underwriter will look at the possibility of LTC/morbidity risk while a life insurance underwriter will look at mortality risk) * Lifestyle (e.g., tobacco use, marital status, type of residence, activities, etc.) * Duplicate coverage |

## Life Insurance as a Solution for Long-Term Care

Though not generally regarded as a way to plan for long-term care, life insurance policies can provide benefits in a similar manner to long-term care insurance. The accelerated death benefit provision and single premium policies are two ways to accomplish paying for long-term care.

Life insurance policies may also have potential value in, at least partially, covering LTC expenses. This may be accomplished in a number of ways, including the following:

1. A policy may contain an ***Accelerated Benefits Rider*** or allow the policy owner to “negotiate” accelerated benefits directly with the life insurance company under certain conditions, such as diagnosis of a terminal illness, diagnosis of certain medical conditions, need for LTC, or confinement to a nursing home.

* Receipt of these accelerated benefits is generally income tax-free and often can leave a balance in the life policy to be paid at death.

1. A ***Viatical Settlement*** may be a viable option if an Accelerated Benefits Rider is not available. Unlike Accelerated Benefit Riders, Viatical Settlements are **not regulated in all states** and an enhanced level of due diligence should be taken to assure fair pricing of a settlement that usually ranges from 50% to 80% of the current death benefit of the policy.

* Typically, the insured will need to be terminal – expected to die within 12 to 24 months.

1. If the life insurance policy has a cash value, it can be surrendered, withdrawn, or borrowed against. This may not be a sufficient source of cash.
2. If life insurance coverage is no longer needed, certain life insurance policies with cash value may be eligible for a tax-deferred (or tax-free) exchange to a long-term care policy. It is generally necessary to complete the exchange before an illness or injury requires long-term care.
3. Borrow funds, possibly from a family member, by transferring ownership to the lender or use the life insurance policy as collateral assignment to cover the loan and interest.

* If the ownership is transferred, this will also relieve the terminal client of premium payment obligations. Keep in mind, however, that life insurance transferred within 3 years of death is includable in the transferring owner’s estate for estate tax purposes.
* Note also that if the insured is under age 65, a Waiver of Premium Rider may be attached to the policy, which typically pays premiums during disability to age 65.

## Considerations in Selecting the Type or Form of Insurance

Having surveyed the various insurance products within the scope of this course, we conclude this section with a listing of considerations for each product. Keep these in mind as you discuss these products with your client. **Click each product solution to view the considerations**.

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| **Life Insurance** |
| The client's circumstances should be considered as primary decision factors. This would include issues such as:   * **How long will the need exist?** This factor could influence the choice of term versus permanent insurance. * **Does the client have the ability to save money without forced savings?** If not, a permanent form of insurance with cash value might make more sense. * **Does the client have a preference as to type of life insurance?** * **What is the purpose of the coverage?** Estate planning would likely indicate a need for permanent coverage. * **Is cost an issue, relative to the client’s other goals?** * **What is the insurability of the person?** |
| **Disability Insurance** |
| Considerations include the type of job (professional or blue collar), available employment benefits, business owner considerations (business overhead insurance, group coverage for their company, key man coverage), amount of coverage offered relative to income, etc. |
| **Long-Term Care Insurance** |
| ***Long-Term Care insurance*** may be appropriate for clients who have too much wealth to qualify for Medicaid and too little wealth to self-insure against the risk of long-term care expenses.  Consideration should be given to local nursing home costs, client preferences toward one institution versus another, and the client’s ability to pay those costs out of pocket. |

We also conclude that with some awareness questions, you can help your client or prospect recognize the need for considering the types of insurance needed and enhance the perceived value you are adding by addressing them.

DocumentationIcon_32px**Click the icon to view example questions.**

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| **Awareness Questions**   * How did your advisor determine the appropriate type of insurance for you to own? * What process did your advisor use to identify the amount of risk you face in relation to your goals? * What process guided your decisions about the type or amount of insurance you have? |

## Review Exercise

**Review your knowledge of disability insurance by answering the following questions.**

1. **A professional who is concerned about disability protection if unable to work his or her chosen profession for which he or she was specifically trained would be best served with which definition of disability:**

* Any Occ
* Reasonable Occ
* Own Occ

1. **The general rule is that when an individual pays premiums on an after-tax basis, then the disability benefits are:**

* Taxable
* Taxable once cumulative benefits exceed premiums paid
* Tax-exempt

1. **The “elimination period” is:**

* The time between the occurrence of disability and the start date of accruing disability benefit payments.
* The time between application for disability insurance and the beginning of coverage.
* The time period after which disability benefit payments cease.

1. **The maximum duration of benefit payments with a long-term disability policy is typically:**

* 20 Years
* 40 Years
* Until age 59½
* Until age 65

1. **Social Security Disability Income of wealthy clients is at least partially taxable.**

* True
* False

1. **In most cases, eligibility for long-term care is based on the number of activities of daily living a person can perform.**

* True
* False

1. **A client tells you she would like to use her life insurance policy to pay for long-term care. What would you suggest the client makes sure she has in her policy?**

* A waiver of premium
* Accidental death benefit rider
* Accelerated death benefit rider
* A guaranteed purchase option

The answers to these questions are found on the following page.

## Review Exercise – Answer Key

**Review your knowledge of disability insurance by answering the following questions.**

1. **A professional who is concerned about disability protection if unable to work his or her chosen profession for which he or she was specifically trained would be best served with which definition of disability:**

* Any Occ

**Incorrect**. With this definition, the person could be unable to perform the job for which they were trained but be unable to receive benefits because the person could still do other jobs, such as working in a fast food restaurant.

* **Reasonable Occ**

**Incorrect**. With this definition, the person could be unable to perform the job for which they were trained but be unable to receive benefits because the person could still do other jobs, such as teaching.

* **Own Occ**

**Correct**. The fact that the person could still perform other jobs would likely be immaterial to the ability to collect benefits if the person could no longer perform the job of his or her chosen profession.

1. **The general rule is that when an individual pays premiums on an after-tax basis, then the disability benefits are:**

* Taxable

**Incorrect**. Try again.

* Taxable once cumulative benefits exceed premiums paid

**Incorrect**. Try again.

* **Tax-exempt**

**Correct**.

1. **The “elimination period” is:**

* **The time between the occurrence of disability and the start date of accruing disability benefit payments.**

**Correct**.

* The time between application for disability insurance and the beginning of coverage.

**Incorrect**. Try again.

* The time period after which disability benefit payments cease.

**Incorrect**. Try again.

1. **The maximum duration of benefit payments with a long-term disability policy is typically:**

* 20 Years

**Incorrect**. Try again.

* 40 Years

**Incorrect**. Try again.

* Until age 59½

**Incorrect**. Try again.

* **Until age 65**

**Correct**. “Lifetime” is sometimes available with certain restrictions if underwritten before age 45 to 50, depending on the carrier. An MBP of Age 65 is more common.

1. **Social Security Disability Income of wealthy clients is at least partially taxable.**

* **True**

**Correct**. Up to 85% of SSDI benefits are taxable if the recipient’s income exceeds certain thresholds, which will typically occur with wealthy clients.

* False

**Incorrect**. Up to 85% of SSDI benefits are taxable if the recipient’s income exceeds certain thresholds, which will typically occur with wealthy clients.

1. **In most cases, eligibility for long-term care is based on the number of activities of daily living a person can perform.**

* **True**

**Correct**.

* False

**Incorrect**.

1. **A client tells you she would like to use her life insurance policy to pay for long-term care. What would you suggest the client makes sure she has in her policy?**

* A waiver of premium

**Incorrect**. A waiver of premium will only protect the insured from having to pay premiums if they become disabled. It does not provide benefits for long-term care. Try again.

* Accidental death benefit rider

**Incorrect**. The accidental death benefit rider increases the benefits if the insured dies an accidental death. Try again.

* **Accelerated death benefit rider**

**Correct**. The accelerated death benefit rider may allow the insured to access benefits prior to death to pay for long-term care.

* A guaranteed purchase option

**Incorrect**. A GPO only gives the policyowner the right to purchase specific amounts of insurance in the future. Try again.

## Need #3 – Determination of Appropriate Levels of Coverage

Most people assume the most valuable asset they own is either their home or their investment portfolio. In reality, their life and their ability to generate income is the fuel that propels the ability to gather all those assets. According to the U.S. Census Bureau, the median price of a house in America is $270,900 while the three-year average household median income in the U.S. is $53,046. If a person works a thirty-five year career at the median, career earnings would be nearly one million nine hundred thousand dollars, without adjusting for inflation or salary increases. Clearly, for most people, a healthy life is their most valuable asset.

How do you go about determining the value of a life? Or in the case of disability or long-term care, how do you determine the level of coverage that is needed?

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| **Overview** | There are a number of common methods and considerations for determining the appropriate amount of life, disability, and long-term care insurance that clients should have. **Click each of the following to learn more.** |
| **Life Insurance** | The level of life insurance coverage needed is typically determined through one of the following approaches. **Click each to learn more.**   |  | | --- | | **Present Value of Expenses** | | Most financial planning software provides some ability to value the amount of life insurance a client needs. This method typically uses a present value of the resources needed to maintain certain expenses, independent of whether they are one-time or ongoing. | | **Life Value** | | This calculation takes into account the present value of all income relative to an individual and assumes that figure as the insurance need. For example, wages earned until retirement increasing with inflation, Social Security income, pension income, and distributions for qualified retirement plans are all combined to produce a life insurance amount. | | **Six or Seven Times Annual Income** | | This “rule of thumb” approach to determining life insurance need is somewhat crude, but often times the result is similar to the result produced by sophisticated planning software.  In determining the level of life insurance coverage needed, it is important to not ignore the non-employed spouse, who is typically responsible for child care, home care, meals, errands, etc. The expense of hiring someone to provide those services for the family can be considerable. | |
| **Disability Income** | Most advisors agree that families require about seventy to eighty percent of the income level they had prior to a disability. Also remember to discuss the client’s retirement income needs if they have not currently saved sufficient resources to support the goal. |
| **Long-Term Care Insurance** | Clients almost always know of someone who has gone into a nursing home or have a family member who has been impacted by the need for prolonged care. According to a survey conducted in 2015 by Genworth, the average cost of a nursing home stay (private room) is about $250 a day, or about $91,250 per year.  When that fact is combined with the potential that a spouse may still be at home with the same level of expenses, many clients would be hard pressed to make ends meet without some form of long-term care insurance. The amount needed will largely depend upon the geographic region, as nursing home costs vary significantly across the U.S., whether or not the client wished to be maintained at home, and how much the client can afford to self-insure.  Of the three types of coverage being discussed, this is one that the client is most likely to defer. However, independent of whether or not a client elects to obtain coverage for long-term care, simply taking the time to converse with the client about protecting the family’s assets from potential costs of personal care will serve to increase the value the client ascribes to your relationship. |

The following questions may be useful in helping your client see the importance of making sure that the level of coverage for these types of insurance is adequate for their needs.

DocumentationIcon_32px**Click the icon to view example questions.**

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| **Awareness Questions**   * What method did your advisor use to determine the level of coverage you needed? * How have you re-evaluated your coverage needs to adjust for changes that have taken place in your life since the policy was first purchased? * How did your advisor take into account the need for coverage for your spouse? |

## Need #4 – Coordination of Insurance with Other Financial Planning Decisions

Insurance purchases should be coordinated with other financial planning decisions. That’s not typically how it happens, however. Unlike investment decisions, our clients are not inclined to evaluate and compare, but rather to purchase from convenience. The result is that most people’s insurance portfolio is disconnected from the remainder of their financial lives.

As an advisor, your role is to demonstrate the value of a more structured and disciplined approach to making these decisions. To fully provide service as a trusted advisor, you must first consider the impact of each interrelated decision. **Click each decision point below to learn more.**

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| **Insurance as a Wealth Management Component** |
| A disciplined, structured wealth management process is fundamental to providing advice for clients. Any client and advisor who would make the effort to agree to an Investment Policy and Asset Allocation should incorporate insurance planning as part of the process. If insurance planning is managed outside of the guidelines, the concept may be weakened as a result. |
| **Taxation** |
| Since permanent insurance builds cash value on a tax-deferred basis and many policies offer options to access the cash value in tax-favored methods, e.g., policy loans, taxation must be considered in conjunction with the insurance decision. The client’s current tax bracket is relevant to any decision to utilize the cash value of a policy, and their expected future tax bracket should be considered when determining withdrawal strategy. |
| **Insurance at the Expense of Other Goals** |
| Once an advisor understands a client’s goals, the priority of those goals must be considered. For example, over-insured persons with insufficient retirement assets might consider their advisory relationship to be less than adequate, as they have not been given proper counsel regarding their retirement planning because the advisor focused solely on the sale of insurance. Conversely, someone might save toward their children’s education and fail to retire as a result of the death of their spouse. |
| **Failure to Consider Estate Planning** |
| Although life insurance proceeds are generally free from Federal income taxes, an improperly owned policy can effectively cause the policy's inclusion in a decedent's taxable estate and have the Internal Revenue Service as a significant beneficiary. |

The following are effective awarenessquestions that you can use to uncover potential opportunities to better coordinate your client’s risk management decisions with the other important financial issues of their lives.

DocumentationIcon_32px**Click the icon to view example questions.**

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| **Awareness Questions**   * How has your advisor incorporated his/her insurance recommendations into your overall strategy? * How does your advisor incorporate tax impacts into your insurance risk management portfolio? * How are insurance decisions coordinated with your investment decisions? |

## Need #5 – Periodic Review of the Plan

The last need to discuss in this course is the need for a periodic review of the insurance plan. In the investment environment, all investment managers realize the need to review and evaluate the plans they are using to guide the construction and maintenance of their client’s portfolios. Unfortunately, clients are not as fastidious about their insurance purchases or recommendations, and advisors have not taken as proactive a role as they might have. In an article titled *Trust Owned Life Insurance: Is It an Accident Waiting to Happen?,* Mark A. Teitelbaum states that even among professional fiduciaries or trustees, little is done to evaluate the ongoing validity of insurance policies. He states, “Among professional trustees, fully 83.5% indicated they had no guidelines and procedures for handling trust-owned life insurance.” He goes on to state, “For non-professional trustees, 71.2% indicated they had not reviewed their trusts’ life insurance policies in the last 5 years.”\* If trustees do this little, the average client cannot be expected to do any better.

Structured Review

The policies that make up a client’s risk management portfolio should be monitored on a consistent basis. Basic information about the financial strength of the carrier, where any risk to the benefit lies, and the relative importance of a policy's potential benefit to the overall risk management portfolio -- these are three considerations that can guide how often reviews need to be conducted. At a minimum, life insurance policy owners should request an in-force illustration every other year. If a given policy falls below expectations by a pre-determined amount, annual reviews may become appropriate.

The amount of insurance considered appropriate should be reviewed similarly, especially whenever there has been a significant change in the client’s circumstances. Many Advisors would recalculate if the client’s marital status changed, their employment changed, there was a birth or adoption in the family, there was a significant change to the financial situation like an inheritance or windfall profit, the client’s goals changed appreciably, or if any other significant life event occurred. The important factor is that, as a trusted advisor, ***you*** ***initiate*** ***the conversation*** around risk management before your client/prospect or your competition does. The following awareness questions can assist you in doing exactly that.

DocumentationIcon_32px**Click the icon to view example questions.**

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| **Awareness Questions**   * How has your advisor measured the ongoing performance of your insurance portfolio? * How does your advisor evaluate your existing risk management holdings? * How do you evaluate the total cost of managing your insurance portfolio? * How has the continued decline in interest rates affected your risk management portfolio? |

*\*National Underwriter (May 17, 2004), pp. 38-43.*

## Conclusion

Thinking of your client’s insurance decisions as another carefully planned portfolio designed to protect their loved ones and their financial goals, and not as commodity transactions, is central to becoming the client’s primary source of financial counsel. The knowledge you have gained in this course will help you achieve that goal.

As you seek to address the insurance needs of your clients, a good place to start is with helping the client identify clear risk management objectives. Most clients will possess policies that were obtained more out of convenience or circumstance, than as the result of a well-thought-out strategy. They have coverage merely because their employer provides it or merely because it was a product that someone “sold” them. You can differentiate yourself by helping the client work through a systematic process that addresses the following issues:

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| * Identification of the types of risk the client deems relevant to his or her financial life * Quantifying the coverage needed to address those risks * Identifying the time horizon around those risks, e.g. current vs. retirement vs. at death * Identifying a portfolio of insurance products that address those risks |

By taking a systematic, holistic approach to identifying and resolving the client’s insurance risk needs, you will take a significant step in becoming or maintaining your status as the client’s trusted advisor.