Today's Objectives

- To discuss individual plans for premature death

Attacking the Problem of Premature Death

- The **Three**-Legged Stool of Premature Death:

  I – Government

  - CPP survivor benefits (see Module 2)
  - Worker's Comp survivor benefits (see Module 4)

  II – Employer

  - Pension Plan Death Benefits (see Module 2)
  - Group Insurance benefits

  III – Individual

  - **RRSP/RRIF death benefits (see Module 2)**
  - **Other savings (see Module 2)**
  - **Insurance**

Individual Life Insurance

1. Importance
2. Types of Policies
3. Whole Life Insurance: Characteristics & Types (Participating vs. Non-Participating)
4. Term Insurance: Characteristics & Types
5. Individual versus Group Insurance

Individual Life Insurance

1. Why is Life Insurance Important?
   – Provides financial protection for individuals, families and businesses
     • Also minimizes worry (provides “piece of mind”)
   – Assists in making “savings” possible for premature death needs
     • Buying a $500,000 Life Insurance policy means that there will be $500,000 available in the event of premature death (vs. trying to set aside annual amounts to accumulate to $500,000)
   – Encourages thrift
     • Regular premium payments would be required (discipline)

Individual Life Insurance

1. Why is Life Insurance Important?
   – Furnishes a safe profitable investment
      - Many insurance policies have a cash value
      - Death benefit (DB) is tax free
      - DB protected against claims of creditors of policy owners and beneficiaries
   – Estate Planning - Can use insurance proceeds to help pay estate taxes

Individual Life Insurance

2. Types of Individual Life Insurance Policies

   1st three types below are ‘traditional’ Individual Ins. types

   a) Whole Life Insurance (more details on following slides)
      - Death benefit paid at time of death regardless of when death occurs
      - Important type of policy
      - This used to be the most widely sold insurance product

   b) Term Life Insurance (more details on following slides)
      - Death benefit paid at time of death if death occurs within *n* years (term of policy), otherwise (if person is living) no benefit is paid
      - Popular, accounts for a substantial volume of all sales

Individual Life Insurance

2. Types of Individual Life Insurance Policies

   c) Endowment Insurance

      - Death benefit paid at time of death if death occurs within *n* years, otherwise (if person is living) benefit is paid out at end of *n* years
      - Not sold in North America, but popular product elsewhere

   d) Universal Life Insurance (classified as 'non-traditional')

      - Accounts for biggest % of recent Individual Ins. sales growth
      - Has an insurance and an investment component
      - Popular estate planning product

Individual Life Insurance

3. Whole Life Insurance: Characteristics & Types
   – A Whole Life (WL) policy pays the face amount (death benefit) at the time of death regardless of when death occurs
     - Face amounts (death benefits) typically are level for the whole policy duration (but can vary)
     - Premiums on most WL policies remain level throughout the premium payment period (but can also vary)

Key Characteristics of Whole Life Insurance

– **Premiums** for whole life policies are **much higher** than for a term policy (with the same face amount)

– **Most whole life insurance products have cash values** (that the policyholder receives if the policy is terminated or canceled before the insured dies)

Individual Life Insurance

3. Whole Life Insurance: Characteristics & Types

Key Characteristics of Whole Life Insurance

- If a policy has a cash value, the policy holder can borrow against the cash value – i.e., **policy loans** are **possible on Whole Life Insurance policies that have cash values**
  - Interest is charged on policy loans
  - If death occurred and the policy loan was not paid off, the death benefit would be reduced by the outstanding loan amount (plus any interest charged)
  - If the policy terminated or matured, the amount paid out would be the Cash value less the o/s loan (plus any interest charges)

Individual Life Insurance

3. Whole Life Insurance: Characteristics & Types

Types of Whole Life Insurance Policies

a) Ordinary Whole Life Insurance

- A policy where the periodic premiums are payable for ‘the life of the policy’ and death benefit (DB) is paid regardless of when death occurs

b) Limited Pay Whole Life Insurance

- A policy where the periodic premiums are payable for a limited # of years, but DB is still paid regardless of when death occurs
- A popular example of this would be a “20-Pay Whole Life Policy” (premiums payable for 20 years)
  - After 20 years, the policy is said to be ‘paid up’
  - Cost of (b) therefore is higher than (a) as it is the same death benefit but the benefit is being funded over a shorter period of time with a limited pay policy

Individual Life Insurance

3. Whole Life Insurance: Characteristics & Types

Types of Whole Life Insurance Policies

c) Participating versus Non-Participating Whole Life Insurance

- With Participating (Par) Insurance, all profits are shared amongst the (participating) policyowners' in the form of dividends
  - Dividends can be taken in cash and other options are also available (e.g. use dividend to offset premiums or buy more insurance, or invest in a short-term account)
- In Canada, 'big 3 insurance companies' are proprietary insurers which means they have shareholders and also have a block of participating policyholders that share in a predetermined proportion of the profits
  - There exists for example 20-Pay Par Whole Life and 20-Pay Non-Par Whole Life Insurance within the same company (that has both Par/Non-Par business) - premium would be higher on the Par policy

Individual Life Insurance

4. Term Insurance: Characteristics & Types
   – A "*n*-year" Term Insurance policy pays the death benefit only if death occurs within the term of the policy (within *n* years)
     - If insured survives to/beyond the end of the term, no benefit paid
     - The term can be set in terms of years – can be 1-year, but generally is longer (e.g. 5, 10, 20-year term)
     - The term can also be to a stipulated age such as Term to 65 (meaning term ends when the insured turns 65)

Key Characteristics of Term Insurance

– By far Term is the least expensive form of insurance

– Term policies do not have a 'cash value" and don't pay out dividends (there is no investment component)
  - Most term coverage is non-participating

Individual Life Insurance

4. Term Insurance: Characteristics & Types

Key Characteristics of Term Insurance

- Term Ins. is '**commodity product**' people want to buy it at the cheapest price
  - Purchasers are price-sensitive - they view term polices as being easily replaceable
- As a result of the above, **lapse rates** (policy surrenders) are therefore **usually highest for term insurance**, and a problem related to this is what is called 'adverse selection'
  - Adverse Selection means people in good health are the ones most like to lapse their policies

Individual Life Insurance

4. Term Insurance: Characteristics & Types

Key Characteristics of Term Insurance

- **Renewability**: Most 1-10 year term policies contain an option that permits the policyholder to continue the policy for a limited number of additional periods of protection
  - Insured does NOT go through underwriting process again, but premium level will increase at each renewal
- **Convertibility**: This feature allows policyholder to convert (exchange) the term policy to Whole Life Insurance without evidence of insurability (means not underwritten again)
  - Those who are not as healthy are more likely to convert - why?
  - Note that their premium will be increased (Whole Life premium)

Individual Life Insurance

4. Term Insurance: Characteristics & Types

Types of Term Insurance Policies

a) Level Face Amount (or Level Death Benefit) Policies

- **Majority of term policies have level death benefits** – i.e., death benefit is fixed and does not change over the life of the policy
- Examples:
  - Yearly Renewable Term (YRT) - premium increases yearly
  - 5-Year Renewable Term
  - Level premiums for 5 years, then increases for next 5 year and so on
  - 20-year non-renewable term – level premiums for 20 years
  - T-65 level premiums to age 65

Individual Life Insurance

4. Term Insurance: Characteristics & Types

Types of Term Insurance Policies

b. Non-Level Face Amount Policies - Examples

- **Mortgage Term Insurance**: face amount or death benefit decreases (intended to cover outstanding balance on a mortgage)
  - This is a very popular product
- **Cost-of-living adjustment**: death benefit is increased to adjust for inflation

5. Individual versus Group Insurance

– Group insurance premiums are typically lower than individual term premiums because, for each individual, there are lower costs of:

- marketing
- underwriting
- administration

As you head into finals, remember…