9 – Life Insurance Planning

**1 – Premature Death Loss Exposures**

An individual’s premature death can have devastating financial consequences when his or her future earnings or the value of the services he or she performs to maintain a home and family is lost.

Unexpected death can occur at any age. However, most life insurers statistically consider a premature death to be any death that occurs before age 65. The premature death loss exposure can affect the ability of potential survivors to make mortgage payments, generate retirement income, meet tax obligations, and designate financial gifts to others.

Life insurance is the means by which individuals and families can reduce or eliminate the financial impact of the premature death loss exposures.

**Costs Associated with Premature Death**

An individual’s premature death can leave a variety of unfulfilled financial and emotional obligations, such as unpaid mortgage, college tuitions, and support for young children. Premature death can occur because of a variety of factors, including family history, personal lifestyle, accident, or environmental factors.

Cost required to support one’s family over a lifetime are significant and can vary depending on the specific type of family structure. When a family’s key wage earner dies prematurely, replacement income is not always readily available. Life insurance is a key financial planning tool that is often used to provide for these **costs associated with premature death:**

* **Lost Income – Decreased wage earner’s income is lost**
* **Final costs – Funeral costs, medical expenses, and so forth**
* **Outstanding debts – Credit card debts, mortgage, and so forth**
* **Unpaid long-term obligations – To supplement retirement savings and fund college tuitions, child-care expenses, home maintenance expenses, and so forth**
* **Estate planning costs – Estate taxes, probate costs, lost charitable contributions, and so forth**
* **Unfulfilled family obligations – Both economic and non-economic, for example, the family’s standard of living may be adversely affected, or a child may grieve over the loss of a parent**.

**Singles Without Children**

Singles without children are individuals who are not married or in a long-term, committed relationship and who do not have dependent children. The IRS recently reported that more than 2/3s of today’s middle-income tax payers are single or members of single-headed households.

A single person may not need life insurance to reduce the financial impact of the premature death loss exposure if no one financially depends on him or her; perhaps just a small amount of life insurance may be required to cover funeral expenses and any uninsured medial expenses. However, younger singles may want to provide financial support for elderly parents or dependent siblings and other family members. Others may require life insurance to cover any significant debt that may be passed on to surviving family members.

**Single-Parent Families**

Singles with children include single parents, single grandparents caring for a child, or other relatives or guardians who fulfill parental responsibilities related to a dependent child or children. Singles with children have many responsibilities, including those related to generating income, managing the household, and providing emotional support to children or other dependents.

The financial impact of the loss of a single person with a child or children can be significant. Frequently, singles with children have little or no life insurance, relying instead on government insurance resources such as Social Security survivor benefits. Additionally, the may consider the cost of life insurance an unnecessary expense at a time when they are already shouldering greater financial and emotional demands. Singles with children can use life insurance as a tool to ensure that their loved ones will be cared for property in terms of housing, educations, and other expenses, and they can use the process of obtaining life insurance (which can include drafting a will) to appoint guardians of their choice for their dependent children.

**Two-Income Families with Children**

Tow-income families with children can include unmarried couples (including relatives or guardians) who care for dependent children. However, this category is primarily populated with individuals who are married and employed and who have children. Increasingly, both spouses in a relationship must work in order to maintain the family’s customary economic standard of living or to attain a higher standard of living.

**The financial impact of the premature death of either spouse in a two-income family can be devastating when dependent children are involved. The loss of one spouse’s earning can affect the surviving spouse’s ability to properly maintain the household, provide for related expenses, fund future retirement, and ensure the financial well-being of the children beyond any governmental benefits they may receive**. Life insurance can enable the family to maintain its “two-income” standard of living.

**Two-Income Families Without Children**

While this category is primarily populated with couples without children or couples whose children have grown out of any dependency, it can also include working grandparents or other relatives who no longer have dependent-child responsibilities.

Married working couples without children or other two-income family arrangements that do not involve children may not be severely affected by the premature death of one wage earner. However, the surviving wage earner may face financial implications that modest amounts of life insurance can address, such as satisfying outstanding indebtedness, supporting aging parents, or other financially dependent relatives, making mortgage payments, supplying funds for retirement, or maintaining his or her current lifestyle.

**“Traditional” Families**

“Traditional” families are those that consist of a mother, a father, and their children. In the traditional family, only one parent is employed, while the other partner manages the household and takes care of the dependent children.

The premature death of one of the parents in this category can generate significant financial uncertainty. The surviving spouse may need to return to the workforce, thus possibly generating child-care costs. Life insurance benefits, in addition to Social Security Survivors benefits, can greatly mitigate this significant uncertainty.

**Blended Families**

A blended family is a family unit in which one or both partners bring with them dependent children from a prior relationship. One or both partners in the blended family may be employed.

The financial impact of the premature death loss exposure on blended families primarily relates to the dependent children’s needs and can be significant. Other unique financial needs of the blended family relate to the dependent children; children from a previous relationship may be older and reaching the ages at which education costs and the costs of supporting them escalate. Children may be born into the blended relationship, extending the timeline for child-care costs. Life insurance can offset the uncertainty of such expenses, particularly when other contractual resources for these expenses, such as alimony and child support, may be limited.

**“Sandwiched” Families**

**Members of the sandwiched generation include baby boomers, now middle-aged, who are providing financial support to both younger and older family members. A typical sandwiched family could consist of an aging parent or dependent family member who receives financial assistance or other types of support from his or her adult child or another younger relative. This same adult child, or younger relative, in turn, supports his or her own dependent children; therefore, this is a generation “sandwiched” between an older and younger generation that both require financial support and care.**

The premature death of a member of the sandwiched generation can have an extensive financial impact. Death of a nonworking member of the sandwiched generation can generate an increase in child-care costs and also other costs related to the nonfinancial support (such as physical care) and support of aging parents or other dependent relatives.

**2 – Determining the Amount of Life Insurance to Own**

The amount of life insurance individuals require usually changes over time, based on their age and needs related to their family structure.

Several methods exist for estimating the amount of life insurance an individual requires in order to reduce or eliminate the financial uncertainty of a premature death. Some life insurers suggest than an arbitrary approach to determining life insurance requirements is sufficient, such as calculating an amount based on a simple multiple (for example 6-8 times) of earnings of the insured individual. Such an approach, while simple, is imprecise and can lead to a shortfall. Two basic methods – the needs approach and the human life value approach - are more precise ways to estimate life insurance.

**Needs approach – method used to determine an adequate amount of life insurance based on the survivors’ needs and the amount of existing life insurance, financial assets and expected Social Security benefits**.

**Human Life Value approach – a mathematical computation used to determine how much life insurance is need by valuing a human life.**

**Needs Approach**

The needs approach is used to identify an adequate amount of life insurance based on survivor’s needs, including those of the decedent’s family or other dependents. It is based on identifying a family’s economic needs after considering its Social Security survivors benefits. An insurance professional using the needs approach would gather facts about a family’s financial needs by asking questions about its economic needs and available resources.

Key Questions asked would be:

* How much is your mortgage payment
* What are your other annual living expenses
* Do you have funds reserved for the kids college education
* How large is your emergency fund
* What is your total credit card debt
* Is anyone relying on your contributions
* Have you estimated your final expenses
* How large are any outstanding loans
* Do you leave money to a charity or any other no-for-profits
* Do you want to leave money to a friend or relative
* What is the potential tax bill on your property or estate

The objective of the needs approach is to determine the total financial requirements of the insured’s surviving dependent family, generating the amount of life insurance or additional life insurance the individual should own.

A needs and benefits/assets review typically generates results that fall not one or more of these financial categories.

**Final Expenses Needs**

Final expenses are incurred immediately before death and immediately thereafter. They can include a decedent’s uninsured medical bills, funeral and burial costs, federal estate taxes, and state inheritance taxes, and any probate costs.

**Debt Elimination needs**

Debt elimination relates to a decedent’s outstanding debt or financial obligations. Mortgage balance owed, credit card debts and funding children’s education

**Family Living Expense Needs**

A family’s living expenses include any expense required to maintain the household, provide for child care, or fund any other expenses related to the daily living. When determining the family’s living expenses, consideration is given to any income that might be generated by a surviving spouse (or that might be lost if that spouse leaves the workforce to support children at home). Also, financial requirements that exceed the surviving spouse’s income, such as the funds required to sustain the family’s current standard of living, are calculated per year and multiplied by the projected total number of years of need (for example, the number of years remaining until retirement or children are financially independent).

**Special needs**

Special needs expenses are expenses that remain or financial obligations that must be funded after an individual’s death. Monetary gifts to family members or charitable institutions, a trust or an emergency fund for unanticipated expenses.

Retirement Income Needs

Retirement income needs relate to the income needed to support a surviving spouse during his or her retirement.

**Life Insurance and Other Assets**

Existing life insurance and any other income-producing assets that can be used to fund survivors’ well being and to help them maintain their previous standard of living are totaled and applied to their financial requirements to determine an appropriate amount of life insurance.

**Human Life Value Approach**

**The human life value approach estimates an individual’s income for his or her remaining working life and factors in other items such as the individual’s age in relation to retirement and the cost of self-maintenance. Cost of self-maintenance means that portion of total wages that the wage earners consumes in the course of daily living; the surplus amount is the remaining wages that go to the family to meet its needs. This surplus is the human life value, which would require replacement in the event of the wage earner’s death.**

A present value factor is applied to the total amount of income requiring replacement-the human life value. Because a human life has economic value only in relation to others, such as children or a spouse, this approach is typically used for families with principal wage earners.

A separate calculation is made to estimate the total of any existing life insurance, savings, and investments and Social Security benefits. A present value factor is applied to any additional income item that is received over time, such as Social Security benefits. This sum is then subtracted from the human life value to determine the total amount of new or additional life insurance required.

The objective of the human life value approach is to determine the total amount of income that is lost when a primary wage earner dies. Teo develop an accurate estimate, one would consider the individual’s net pay rather than gross pay, include the other economic factors noted; and supply an estimate of the interest rate that could be earned, on average, over the individual’s expected working period. These items are then applied to a present value computation.

**The human life value approach, which focuses on replacing a primary wage earner’s lost income, typically develops a lower appropriate insurance amount than does the needs approach, which also considers any unusual expenses (such as for additional child care required.)**.

**3 – Types of Life Insurance**

Some policies provide a savings mechanism that increases the value of the policy over time and that may be used even while the insured is living.

These common types of insurance meet the needs of most insureds, but specialty products offer benefits that are tailored to meet the specific needs of particular insureds.

**Term Life**

Term life insurance is often called term, term life, or term insurance. As its name implies, term insurance is life insurance that provides coverage for specified period. Such as ten or twenty years, with no cash value. If the insured dies during the policy term, the policy value is paid to the beneficiary. It has no savings, investment, or cash value/loan value aspect.

**Term life is useful to someone whose current need for life insurance will diminish after a number of years.**

Term is often a low-cost way to obtain life insurance to protect income during critical times. For some term policies, premiums increase with the insured’s age and are based on mortality rates. Because mortality rates increase with age, term insurance premiums also increase. However, a popular form of term (level term) has a fixed annual premium for a fixed number of years. Insured with level term pay a higher rate in the early years in exchange for a flat, affordable rate in the later years of the term.

Most term policies carry some guarantee of renewability, so that the insured can continue the insurance beyond a fixed number of years (although doing so may require a higher rate). Most term insurance policies are renewable for a specific period or to a specific age. Insurer typically do not allow renewal after a certain age, such as 65, 70 or 75. Some insurers guarantee renewability to an older age, such as 95 or 99.

Many policies are also convertible, so that the insured may exchange the term policy for a whole life policy without meeting any new insurability requirements such as a physical examination.

**Whole Life**

**Whole Life – Life insurance that provides lifetime protection, accrues cash value, and has premiums that remain unchanged during the insured’s lifetime.**

Whole life insurance is a hybrid combination of life insurance and an investment vehicle. Unlike term, its coverage is not limited to a fixed period. Whole life is permanent life insurance designed to provide coverage for a lifetime.

**For a given amount of coverage, the annual premium for whole life is higher than for term life.** The selling point for whole life, given that it costs more than term for the same amount of coverage, is that whole life is a savings vehicle that develops a cash value as time passes. In the early years of a whole life policy, insureds pay and annual premium that covers more than the projected mortality costs for insureds of that age. In effect, the extra money is used to build the cash value.

The cash value, with some limitations, is available to the insured during the life of the policy, either as a loan or as a cash payment upon surrender of the policy. Whole life is suitable for someone who wants permanent protection and who needs the discipline of paying insurance premiums to enforce savings. To determine suitability of a whole life policy, you might compare the annual premiums to those of a term policy for the same coverage amount and then calculate the savings that might accumulate for the term insurance buyer by investing the difference in premiums.

**Compared with term life, the higher cost of whole life insurance could prompt an insured who has limited disposable income to underinsure. For example, an insured who is attracted to the savings feature of the whole life (ordinary life) policy to provide for her children’s future needs might purchase $100,000 ordinary life policy with a premium that matches her disposable income. Instead, that disposable income might be used to purchase a $500,000 twenty-year term life policy, which would better meet her family’s needs in the event of her untimely death.**

**Unlike term, whole life is available to meet financial obligations that continue for a lifetime, such as the expense of a last illness and funeral**. Also, whole life can be useful for estate planning; for example, a policy may be used specifically to reduce estate shrinkage by taxes.

**Universal Life**

**Universal Life – Flexible premium permanent life insurance that separates the protection, savings, and expense components**.

Universal life insurance policies have more in common with whole life than with term life. Like whole life, universal life is a permanent product that combines life insurance protection with an investment or savings aspect. Universal life can be considered a modern twist on the traditional whole life product.

The basic premise of universal life is like that of whole life: the insured makes premium payments that exceed the amount needed to cover the mortality risk (cost of insurance). The policyholder accumulates cash value from the amount of premiums paid in excess of the cost of insurance protection and expenses.

The unbundling of the insurance protection, savings, and expense components is the distinguishing characteristic of universal life. Policyholder receive an annual disclosure that shows the amount of premiums paid, the amount of insurance (death benefit), expenses, and interest earned and credited on the cash value.

Another hallmark of universal life is that two interest rates are stipulated in the policy. One is a guaranteed minimum rate, such as 2.5%. The cash value of the policy is guaranteed to earn interest at that rate or higher. The other rate is the current market interest rate; if that rate is higher than the guaranteed minimum rate the cash value will earn at that higher rate.

For most universal life policies, the insured’s premium payments are flexible, provided that there is enough cash value in the policy to cover the cost of insurance and expenses. The insured may increase, decrease, or even miss a premium payment. The insured can pay higher premiums in order to grow the cash value. The appeal to the insured is that the growth in cash value is tax-deferred.

Flexibility is a fundamental characteristic of universal life. In addition to the flexibility with premium payments, the insured has options to increase the death benefit, borrow against the cash value, withdraw from (and thereby reduce) the cash value, or add insureds to the policy.

Universal life appeals to insured who want to combine life insurance protection with an investment. As noted, the tax-deferred accumulation of cash adds to the appeal, as does the flexibility with premium payments.

There are risks to universal life. The flexibility allows insureds to be less than fully committed to a premium payment discipline, and policies can lapse when premiums are not paid and the cash value is insufficient to cover the cost of insurance and expenses. Also, insureds may expect a certain level of earnings on the cash value, based on current interest rates. In an environment of falling rates, the cash value may grow more slowly than hoped.

**Variable Life**

**Variable Life insurance – a form of life insurance providing a death benefit that may change with time due to its variable cash value.**

**A variable life insurance policy is similar to a whole life policy in that it provides cash value over time and permanent insurance protection, but it enables policyholder to choose among investment accounts (mutual funds made up of common stocks, bonds or other investments) offered by the insurer and to move cash values among these accounts.** The investment performance results of the accounts affect the amount of the policy cash values and sometimes the death benefit.

Variable life insurance offers level premiums and is appropriate for persons who wan the benefit of using competitive investment strategies and some protection against inflation over the life of their insurance program. However, investment performance of stocks and bonds can vary considerably, and the policy should be held for several years, such as 5, 10, 15, or 20 to take full advantage of the flexible investment benefit. A significant advantage of variable life insurance over many other investments is that the policyholder can move the policy cash value amount among investments without incurring any current income tax liability for capital gains.

**Variable Universal Life**

Variable Universal Life- a form of universal life insurance that allows the policyholder to make fund choices for the investment component but that has no guaranteed cash value an no guaranteed interest rate.

Variable universal life insurance combines the features of universal life insurance and variable life insurance. The cash values in variable universal life insurance are not guaranteed, nor is any minimum interest rate. The cash value of the policy is determined by the investment experience of a separate account that is maintained by the insurer. However, the policyholder can select the separate account in which the flexible premiums are invested.

Under variable universal life insurance, insurers impose significant initial expense charges and sometimes surrender charges (based on potential sales charges) for managing policyholder investment accounts. The latter charges decline after the policy ages ten to fifteen years and usually reach zero. Insures may charge annual (or periodic) investment management fees, expense charges, and sometimes other administration fees. In addition to all of these “expense loadings” of variable universal life insurance policies, insurers charge for the mortality cost of insurance protection provided by the policy. This charge varies with the insured’s attained age to reflect the insurer’s exposure for the policy.

**Other Types of Life Insurance**

**Current Assumption Whole Life**

Current assumption whole life (also called interest-sensitive life insurance) includes features of a traditional whole life policy and universal life policy. Under the current assumption policy, the premium and the cash value can be periodically recalculated by the insurer, based on new actuarial assumptions (drawn from the insurer’s investment results and loss experience). The insurer guarantees a minimum interest rate, and some insurers offer maximum mortality and expense charges. These policies can have an appeal at a time when interest rates are rising because higher investment earnings for the insurer can result in reduced premiums and/or increased cash value for the policyholder.

**Second-to Die (Survivorship) Life Insurance**

Traditionally, life insurance policies pay the death benefit at the death of the insured person. In a second-to-die policy, two lives are insured in a single policy, with death benefits payable to the beneficiary when both insureds have dies. The two lives insured are frequently those of a married couple, with the death benefit contemplated to pay for the federal estate taxes due in larger estates.

These survivorship policies can be traditional fixed-premium whole life policies, current assumption policies, universal life or even a combination of permanent and term life insurance.

**First-to-Die (Joint) Life Insurance**

Like second to die life insurance, first-to-die policies cover two individuals. The difference is that the death benefit is payable upon the first death. Typically, the buyers are a married couple, often with two incomes. Although the premiums are typically higher than for second-to-die policies, this option is less costly than taking separate policies on each life.

**4 – Sources of Life Insurance**

The sources from which an individual should obtain life insurance depends on his or her coverage needs and budget. Life insurance may be purchased individually, be group-based, or government provided. These three sources are distinguished by cost, the payer, and the standards applied to providing coverage.

When consumers purchase their own life insurance, they may choose from a wide variety of products, such as term life, whole life, universal life and variable life. Unlike group life insurance, individual life insurance coverage is not tethered to the insured’s employment status or subject to the kinds of changes that might be made to a group insurance plan. This stability and the ability to choose, however, entail a trade-off. As opposed to other sources of life insurance, which limit the insured’s coverage options, the cost of individual life insurance does not include a group or volume discount.

**When a consumer buys an individual life insurance policy, he or she bears its entire cost, which varies based on his or her age, gender, health and habits**. Additionally, each application for individual life insurance must be evaluated by the insurer, increasing its cost**. Individual life insurance is an ideal choice for younger individual who are in good health, as they may find that their positive age – and health – related attributes present premiums that are more attractive than those from other sources of life insurance**.

In contrast with individual life insurance, group life insurance provides coverage to a number of individuals under one mast contract issued to a sponsoring organization. The insured members are not parties to the contract and receive certificates of insurance as evidence of their protection, as opposed to individual policies. **Employers represent the largest category covered by group insurance. Employers groups can consist of individual employees or can be multi-employer arrangements. Group life insurance plans can be financed solely by employers (noncontributory plans) or might require contributions from employees (contributory plans).**

The third primary source of life insurance coverage is through the federal government as part of Social Security benefits. **Social Security benefits include monthly death benefits for surviving spouses, dependent children, and dependent parents.** These benefits accrue during an individual’s years of employment in the same manner as other Social Security benefits. A maximum amount applies to the benefits that can be paid to surviving spouses and other surviving family members. In most cases, this limit ranges from 150 – 180% of what would have been the decedent’s primary insurance amount if they were retiring at that time.

Group Life Insurance Benefits, the amount of life insurance may be determined automatically, through a formula or schedule, to minimize adverse selection. However, in some plans (known as flexible benefits or cafeteria-style plans), employees can choose from among a number of kinds an amounts of employee benefits, and thus tailor their own benefit plans that include group life insurance**. Although many formulas and schedules are available for relating the amount of insurance to earnings, popular practice is to provide life insurance equal to some multiple of the employee’s annual salary, often one, two, or three times rounded to the nearest $1,000. Many insurers stipulate a minimum and a maximum amount of insurance that can be issued on anyone life within the group**.

**5- Common Life Insurance Contractual Provisions and Riders**

Common contractual provisions in life insurance policies stipulate how coverage will be provided and specify the conditions under which benefits will be paid. Riders are additions to life insurance contracts that customize the policies to better meet the insured’s needs.

**Common Life Insurance Contractual provisions**

**Assignment Clause Provision**

A life insurance policyowner can assign eth policy to another person (typically contingent upon insurer notification). **An absolute assignment transfers all ownership rights to another party. A collateral assignment assigns the policy to another as collateral for a loan**. A collateral assignment transfers only certain policy rights to a creditor.

**Beneficiary Designations**

Various types of beneficiaries can be designated in a life insurance policy. Most policies indicate a primary beneficiary, the first one to collect benefits under the policy. Some policies name a contingent beneficiary to receive benefits if the primary beneficiary is not alive at the time of the insured’s death. The policyowner may also designate beneficiaries as either revocable or irrevocable. A revocable beneficiary designation denotes that the policyowner can make beneficiary changes without the beneficiary’s consent. An irrevocable beneficiary designation means beneficiary changes must have the beneficiary’s consent.

**Dividend Options**

**Life insurance policies that pay dividends are called participating policies. An insurer may pay dividends based on its favorable loss, expense, or investment results. Dividends, however, are not guaranteed. Several dividend options are available:**

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| **Option** | **Description** |
| **Cash Option** | **Dividends are paid in cash, usually at the policy anniversary date** |
| **Accumulated Option** | **Dividend amounts remain with the insurer and accumulate interest*. Dividends and accumulated interest can subsequently be withdrawn at any time or can be paid in addition to death benefit amounts*** |
| **Premium reduction option** | **Dividend amounts can be applied to pay for future premium payments due** |
| **Paid-Up additions** | **Dividends may be used to buy increments of paid-up whole life insurance*, which would increase the amount of the death benefit paid under the policy*** |
| **One-year term insurance** | **Dividends may also be used to purchase term, rather than whole, life insurance for one year if the insured dies within that time, the term life amount is added to the death benefit payable under the policy.** |

**Excluded Risks**

**Some life insurance policies specify types of losses that are not covered. Such exclusions usually involve hazardous occupations or recreational activities of the insured. Such as death during active military service, or while in an aircraft other than a commercial airliner**. Some life insurers would decline to provide coverage, or provide only modified coverage, for a sports car enthusiast who regularly takes part in weekend auto racing events.

**Grace Period**

For most policies, the grace period is 31 (thirty-one days). If an insured dies during the grace period, death benefits would still be paid. Generally, the death benefit is reduced by the overdue premium amount that is due the insurer.

**Incontestable Clause**

**The incontestable clause designates a period, usually 2 years, after which the insurer cannot deny a claim because of any misrepresentation on the part of the policyowner.**  Therefore, any fraudulent or misrepresentation information provided by the policyowner on the application can serves as the basis for the insurer’s contesting a claim during the contestable period.

**Misstatement of Age or Sex**

The misstatement of age or sex provision allows the insurer to adjust the death benefit on a life insurance policy to reflect the true age and sex of the insured based on the amount of premium paid if it determined that a misstatement of age or sex occurred. If a misstatement is discovered – either during the policy period or at the time of death – there could be an adjustment in the face value of the policy or in the amount of premiums owed. **For example a policyholder may be issued a refund if the misstatement was of an older age at the time of policy issuance; or charged more if the misstatement was of a younger age at the time of policy issuance. A misstatement of sex is also treated by adjusting the face amount of the policy (when different premiums apply for males and females)**.

**Nonforfeiture Options**

**Nonforfeiture options are provisions in a life insurance policy that give the policyowner a choice of ways to use the cash value if the policy is terminated and that protect the policyowner from forfeiting the cash values.**

* **Cash surrender value** – surrender to policy for cash all obligations under the policy will cease, any outstanding loan amounts would be deducted from the cash surrender amount
* **Reduced paid-up insurance** – the policyowner may elect to use the accumulated cash value in the policy to purchase a paid-up insurance at a reduced face amount.
* **Extended term insurance** – the policyowner may choose to continue the full death benefit of the original policy, but for a shorter period under a term policy.

**Policy loan Provisions**

Life insurance policies that accumulate cash value contain a policy loan provision. Under this provision, policyowners can borrow an amount up to the cash value of the policy, subject to interest. If a policy loan is not repaid at the time of the insured’s death, outstanding loan amounts (including interest) are deducted from the death benefit amount.

**Reinstatement Clause**

A reinstatement clause allows a policyowner to reinstate a life insurance policy that has lapsed for nonpayment of premium. Most insurers allow reinstatement within a specified period such as 3-5 years after the policy has lapsed. Most reinstatement clauses require the policyowner to provide evidence of insurability, pay all outstanding premiums with interest, and repay any outstanding loans, including interest.

**Settlement Options**

Death benefits under a life insurance policy can be paid to the beneficiary in a single lump sum. The policyowner or beneficiary, however, may select form additional settlement options.

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| **Option** | **Description** |
| **Interest Option** | The life insurer retains the death benefits and pays only the interest to the beneficiary at periodic intervals – generally used on an interim basis until the lump-sum payment or another settlement option is made |
| **Fixed-period Option** | **The death benefits are paid over a specified period of time**. The amount of the periodic payment is a function of the amount of the death benefit, the rate of interest paid on the balance of the death benefit held by the insurer, the frequency of benefit payments, and the period selected by the beneficiary |
| **Fixed-amount Option** | **Death benefits are paid in fixed amounts at predetermined intervals**, usually monthly. Interest payments are included in the fixed amount, which may extend the time period during which the payments will be made |
| **Life income Option** | **The beneficiary receives the death benefit over his or her life**. Life income options may include a no-refund option, which will pay benefits only until the death of the beneficiary. Other life income options would allow for payments remaining after the primary beneficiary’s death to be paid to a contingent beneficiary. Life income amounts are based on actuarial tables using eh beneficiary’s age and sex |

**Suicide Clause**

All life insurance policies contain a suicide clause that protects life insurers from adverse selection that could occur if a person planning to commit suicide purchases a large amount of life insurance shortly before ending his or her life. Most policies will refund the premium to the beneficiary is a suicide occurs within the first 2 years of the policy.

**Common Life Insurance Riders**

Rider – similar to an endorsement; modifies a life insurance policy.

**Accelerated Death Benefits**

Traditionally, life insurance was a means to pay for final death expenses after an insured dies. In the case of catastrophic or terminal illness, however, the insured may need to access life insurance benefits to finance medical expenses before death. Some life insurers offer riders that provide for the discounted value, or portion of such value (such as 50%), of the policy death benefit to be paid to the policyowner in the event of certain contingencies, such as terminal illness (an illness that would result in death within about one year). Other riders may cover a catastrophic illness (such as cancer), or the need for long-term care in a nursing home or similar facility. Accelerated death benefits resemble viatical life settlements, in which the life insurance policy is sold to a third party, who becomes the beneficiary in the event of the original insured’s death. The insured receives an amount, generally less than the face value of the policy but more than the accumulated cash value, and relinquishes his or her interest and that of any beneficiaries.

**Additional Life Insurance Riders**

**Accidental death benefits – the accidental death benefit (often refereed to as “double indemnity”) provides an additional death benefit when death results from accidental bodily injury, or accidental means, as defined in the rider**.

Disability income rider – a disability income rider may be added to a life insurance policy to provide a regular monthly income if the insured becomes permanently disabled. Most riders specify a level of income for a determined period of time.

Guaranteed insurability rider – is added to many policies, particularly those issued to younger insureds, and can guarantee access to coverage if a policyholder becomes uninsurable due to poor health in the future. It must normally be purchased before a certain age, often forty.

Waiver of premium rider – under the waiver of premium, the insurer agrees to waive the payment of any premium falling due while the policyowner or insured is disabled, as defined in the waiver of premium provision.

**Case Study**

**Needs Approach** -Analysis Steps

Expense Needs – The goal of this review is to determine how much money will be required to maintain the family’s current standard of living should X die prematurely. In this case, assume the wife would continue to work in her current job with the same retirement benefits and that she would also receive SS benefits at retirement age. If the wife planned to change jobs in the event of X’s premature death, the expense need projections would be adjusted. For example, the new job may have a higher salary or different retirement benefits. The wife’s current employment allows the family to avoid child-care expense because of her house and she is home during summer vacation. If she were to change to a job that had longer hours and required her to work during the summer, the needs calculation would have to reflect additional child-care expenses.

Final Expense Needs

* Funeral Costs
* Estate settlement
* Federal taxes
* State taxes

Debt Elimination Needs

* Satisfy outstanding mortgage(s)
* Fund children’s education
* Eliminate outstanding credit card debt
* Eliminate outstanding car loan

Family Living Expenses Needs

* Household maintenance expenses
* Other living expenses
* Child-care expenses

Special Needs

* Emergency Fund (emergencies or charitable donations)

Retirement Income Needs

* Supplemental retirement income (401(k)) funding

Special

The next step would involve considering whether the family has an expense related to special needs in addition to maintaining its current standard of living. Such expense could include gifts to charitable institutions or establishment of a trust. The only special need is establishing an emergency fund that would cover any unanticipated expenses following X’s premature death.

Retirement Income Needs

After the family’s living expense needs are calculated, it is necessary to consider how much income the wife would need in retirement. This calculation is based on her age at the death of X and other sources of retirement income, including her defined benefit pension plan and SS benefits. Much of X’s and his wife’s funding for retirement is based on X’s 401(k) proceeds. In the event of X’s premature death, the wife would need to supplement her retirement income to cover all of her living expense.

Total Needs

**The final step of the needs approach is adding all of the calculated expense needs to determine the total dollar amount required to meet monthly, ongoing, special and retirement income needs**. This amount will form the basis for determining whether X is carrying a sufficient amount of life insurance or whether additional insurance should be purchased.

Assets Available

After all the needs have been reviewed and calculated, the next step is to determine the dollar amount of assets that are available to meet these needs. These assets include group life coverage, retirement account, and benefits that would be paid by social security until she reaches retirement age. SS will, however, pay monthly survivor’s benefits to the children until they turn 18 (in most cases).

**Total Life Insurance Needs**

**After all the family’s expense needs have been identified and compared to the available assets, the insurance professional would be ready to advise them regarding the adequacy of their current life insurance program**.

**Total Life Insurance Needs:**

* **Total Needs $1,065,000**
* **Minus total assets $818,000**
  + **Additional Life Insurance Needed $247,000**

Recommendations

Based on this review, it is recommended that they purchase an additional $247,000 of life insurance.

Types and Sources of Life Insurance

Term life would be cost effective and close the current gap in assets required to meet the family’s needs in the event of a premature death.

Group universal life and individual term life. If his employer sponsored group life plan allows it, x could purchase an additional $120,000 increment under that plan and purchase the remaining from a life insurer under an individual term policy. The advantage of purchasing additional universal life insurance is that it provides permanent coverage (as long as X is employed) and builds cash value.

Life Insurance Contractual Provisions and Riders

The couple would need to designate beneficiaries in the policy, primary would be the wife and contingent the children.

Settlement options, lump-sum are often paid. She would need to consider her employment situation, the children’s ages, and the family’s needs at the time of X’s death. She may decide that a fixed-period option would be more appropriate than a lump-sum.

X may consider adding a disability income rider to the life insurance policy if he does not already have disability coverage in place. This would provide a regular monthly income for a specified period is he were to become permanently disabled.