LICENSE COACH

Life Insurance Topics

TYPES OF POLICIES

As you learn about the different types of life insurance, recall that life insurance protects against the risk of premature or untimely death. Keep in mind that your duties as an insurance producer involve helping clients select the appropriate types of coverage to fulfill their needs. Learn the distinguishing features of each policy.

Here is a general overview of different classes of insurance:

Types of Policies

Whole Life	Interest/Market-Sensitive	Term Life	Combination Plans
Ordinary (Straight) Life	Universal Life	Level	Joint Life
Limited-pay Life	Variable Whole Life	Decreasing	Survivorship Life (Second to Die)
Single-Premium Life	Variable Universal Life	Return of Premium	
Adjustable Life	Interest-sensative Whole Life	Annually Renewable	
	Equity-indexed Life	Increasing Term	

Group versus Individual

Individual	Group
Individual issued policy	Master policy issued for group
Individual selects plan	Group selects plans to pick from
Individual apply	Eligible employees apply
Individual underwriting	Group underwriting
More expensive	Less expensive
More restrictive	Less restrictive

- Group Life Insurance provides life insurance to many people under one policy. A master policy is issued to the organization, and individual certificates evidencing coverage are given to each member insured.
- Individual Life Insurance is issued on the life of one individual, with individual underwriting, rates, and coverage.

Permanent versus Term

- Permanent Life Insurance is whole life insurance that is effective for the entire life of the insured or up to age 100. Whole Life is permanent protection plus the

cash value.
- Term Life Insurance is effective for a temporary period of time, designated by the policy. Term Insurance has no cash value and is temporary.

Participating versus Nonparticipating

- Participating Life Insurance policies are policies that pay dividends to policyholders, who have the option of receiving the dividend in cash, accumulate at interest, purchase more coverage, reduce premium prices, pay up the entire policy, or purchase 1-year term insurance. Mutual Insurance companies are participating.
- Nonparticipating Life Insurance policies are policies that pay dividends to shareholders, not policyholders. Stock Companies are nonparticipating.

Fixed versus Variable

- Fixed Life Insurance policies earn a constant rate of interest thereby providing a guaranteed minimum of benefits.
- Variable Life Insurance policies earn a fluctuating rate of interest and do not guarantee a certain cash value.

A. Traditional whole life products

Whole Life Insurance provides permanent life insurance protection for the insured's entire life, and living benefits including cash values and policy loans. Cash value in a whole life policy is a nonforfeiture value meaning that the policy owner is guaranteed to it. Policies are issued based on the insured's original, or issue age (age at application).

1. **Ordinary (straight) life**
   Ordinary, or straight life, is basic whole life insurance with a level face amount, and level premiums payable over the insured's entire life.

2. **Limited-pay and single-premium life**
   Limited Payment (LP) Whole Life Policies: The insured is covered for his entire life, but premiums are paid for a limited time. Face amount and premiums are level.
   Single Premium Whole Life Policy: It allows the insured to pay the entire premium in one lump-sum, and have coverage for the insured's entire life. Policies have a level face amount.

3. **Adjustable life**
   Adjustable Life policies are a mix of whole and term life insurance. Changes that can be made to the policy: raise or lower premium, raise or lower the face amount, change the coverage period, and change the premium-paying period.

Traditional Whole Life

	Death Benefits	Premiums	Cash Value
Ordinary (Straight) Life	Level Face Amount	Level premiums payable over the	Cash value is a nonforfeiture value

		insured's entire life	and is guaranteed.
Limited-pay		Level premiums paid for a limited time	
Single-premium Life		Premium paid in one lump-sum	
Adjustable Life	Face amount can be adjusted	Premiums can be raised or lowered	

B. Interest/market-sensitive life products

Variable insurance provides a way for policyowners to earn higher investment returns on life insurance policy cash values. With traditional whole life insurance, premiums are invested in the insurer's general account, which contains conservative investments carefully selected and insured by the insurance company. Interest rates provided by the general account are fixed and conservative, in the 3% – 5% range.

With variable life insurance, on the other hand, policyowners have the opportunity to earn higher interest rates. The interest rate is variable because it is linked to the insurer's separate account, which fluctuates according to its investment performance. Since the separate account is not insured by the insurance company, the investment risk is borne upon the policyowner.

Variable life insurance products are securities contracts and are regulated by the Securities and Exchange Commission (SEC). Agents selling variable products must have a life insurance and a FINRA representative license.

1. **Universal life**
   Universal Life is also referred to as flexible premium adjustable life insurance or unbundled insurance. The primary difference between adjustable life and universal life is that the policy owner can skip premium payments as long as there is enough cash value in the policy to cover the cost of death protection. Policy allows the policy owner to "buy term and invest the difference." Two premiums are quoted to the policy owner: the target premium and the minimum premium. Paying the target premium will build cash value in the policy, and the policy will resemble whole life. Paying the minimum premium will keep the policy in force by paying the cost of death protection, and the policy will resemble term life.

   There are two death benefit options for universal life policy owners:
   1. Option A (Option 1): pays a level death benefit.
   2. Option B (Option 2): pays an increasing death benefit: face amount and cash value.

2. Variable whole life

Variable whole life or simply variable life has fixed level premiums and a guaranteed minimum death benefit just like ordinary whole life but differs in that it offers higher interest rates defending the policy owner against the effects of inflation.

- Only variable life policies allow policy owners to invest premiums in the insurer's separate account.
- Variable life insurance policies do not guarantee cash value.
- Any agent selling variable products must have a securities license in addition to a life insurance license.
- Variable policies have fixed premiums and a guaranteed minimum death benefit.
- The investments are in a Separate Account.
- Producers must be registered with FINRA.

3. Variable universal life

It is universal life insurance with a separate account. These policies have the flexible features of universal life and the investment choices of variable life. Variable universal life policies are regulated as variable products. Features include:

- Flexible premiums,
- Cash value based on investment in separate account,
- Access to cash values (policy loans and withdrawals),
- Death protection deducted from cash value,
- Death benefit option A or B; and
- Policy owners choose sub-account investments.

4. Interest-sensitive whole life

Interest-sensitive whole life, also known as current assumption whole life, provides flexible (varying) premiums based on a changing current interest rate.

- The insurer may raise or lower the premium within a specified range stated in the policy.
- Higher interest rates allow the insurer to reduce the premium, and lower interest rates require the insurer to raise the premium.
- If the insured does not want to pay higher premiums, the policy face amount can be reduced.
- Premium changes usually occur annually.

5. Equity-indexed Universal life

Equity indexed universal life works the same way as universal life insurance, except the interest rate is tied to the stock market index, which has the potential to offer greater cash value growth than universal life insurance.

Equity indexed universal life policies have a fixed guaranteed interest rate and a nonguaranteed indexed rate which can reach yields of 15% - 20% or more. This allows policyowners to reap the benefits of indirectly participating in the stock index. Typically, insurers use the S&P 500 Index.

Interest/ Market Sensitive

	Death Benefits	Premiums	Cash Value
Universal Life	Option A: level	Pay the target	Any cash value

	death benefit; OR Option B: increasing death benefit	premium to build cash value; OR Pay the minimum premium to cover the cost of death protection	above the cost of insurance is guaranteed
Variable Whole Life	Guaranteed minimum death benefit	Fixed level premiums that can be invested in insurer's separate account	Cash value NOT guaranteed; Higher interest rates defend against inflation
Variable Universal Life	Option A: level death benefit; OR Option B: increasing death benefit	Flexible premiums that can be invested in insurer's separate account	Cash value is based on investment and NOT guaranteed
Interest-sensitive Life	Policy face amount can be reduced to offset paying increased premiums.	Flexible changing premiums based on current interest rates	Any cash value above the cost of insurance is guaranteed
Equity-indexed Life	Option A: level death benefit; OR Option B: increasing death benefit	Flexible premiums with interest tied to stock market index.	Cash value from a fixed guaranteed interest rate plus the option of a nonguaranteed indexed rate for larger return.

C. Term life

Term life insurance provides pure death protection since it only pays a death benefit if the insured dies during the policy term. Term life insurance does not accrue cash value.

1. Types

Level Term: Level policies provide a level face amount throughout the policy period. Two types: annual renewable term and level premium term.

Decreasing Term: Policies that provide a face amount that decreases to zero over the policy period. The face amount equals zero on the day the policy expires. The premiums are level. E.g. mortgage reduction insurance.

Return of premium: A new kind of policy is called the return of premium (ROP) term policy. ROP term policy premiums are generally higher than a conventional term policy. The longer the term, the lower the premium. Premiums are returned to the insured if no death benefit has been paid and are not taxable.

Annually renewable: A type of level term policy that has a level face amount and increasing premiums.

Increasing term: Insurance that provides an increasing face amount with level premiums.

2. Special features

Renewable Term Policies: Policies that allow the policy owner to renew the term policy after the designated term expires without having to prove insurability.

Convertible Term Policies: Policies that allow term life policy owners to convert their term insurance into permanent policies without showing proof of insurability. Upon conversion, a convertible term policy will have higher premiums because permanent protection is more expensive than term protection.
Original Age-The original age is the insured's age upon conversion.
Attained Age- The attained age is the insured's age upon purchase of the term policy.

D. Annuities

While life insurance protects against the risk of premature death, annuities protect against the risk of living too long. The risk involved with living too long is depleting financial resources and savings.

At its most basic, an annuity provides guaranteed income for life by systematically liquidating an estate. Two of the most common uses of annuities are providing lifetime income and accumulating money for a retirement fund.

1. Single and flexible premium

Single Premium
Annuities may be funded with a single lump sum premium. This immediately creates a principal sum. Annuities funded with a single premium are either:

- Single Premium Immediate Annuity (SPIA): A lump sum payment is made with the insurer, and payments to the annuitant start immediately; or
- Single Premium Deferred Annuity (SPDA): A lump sum payment is made to the insurer, and the payments to the annuitant are deferred until a specified time. The monies deposited grow tax-deferred until annuitization.

Flexible Premium

A flexible premium arrangement is similar to a level premium annuity, except that the owner of the annuity can elect to pay varying amounts for each premium payment.

- The amount of each premium payment must fall within a certain minimum and maximum amount.
- An annuity where both the premium amount and frequency of premium payments are flexible is called a *flexible premium deferred annuity* (FPDA).

- Flexible premium annuities are appropriate for individuals who have fluctuating incomes, or who are unable to pay for an annuity in one lump sum.
- The major drawback of flexible premium annuities is the inability to determine the actual amount of the annuity benefit.
- Because the amount of each premium payment to be paid and the total amount that will be paid into the annuity is a flexible amount that depends on future premium payments, there is no way to determine the exact amount of the annuity benefit that will be received until the final premium payment is received.

2. Immediate and deferred

Annuities can be broadly categorized into two types: immediate and deferred. These two types refer to when the annuity phase (payout period) begins.

- Immediate Annuities are annuity payments that begin immediately after the annuity is purchased, do not have an accumulation period, and have payout periods which must begin within one year of the first premium payment.
- Deferred Annuities have annuity periods beginning sometime in the future, after one year from purchase, or later. It can be purchased with one or multiple premium payments.

3. Fixed and variable

Fixed Annuities

Fixed Annuities have a guaranteed minimum interest rate at which the premium payments accrue interest during the accumulation phase and a fixed interest rate at which level annuity payments are paid during the annuity phase. Premiums for a fixed annuity are invested in the insurer’s general account. Fixed annuities pay a level annuity payment throughout the annuity phase.

Variable Annuities

Variable Annuities have variable interest rates and benefits, and the insurer cannot guarantee a certain dollar amount periodic annuity benefit. Policy owners choose where their premiums are to be invested. Premiums can be invested in the insurer’s general account and/or separate account.

The separate account is specifically used for variable investments. Variable annuities are considered securities products, and as such must be registered with, and are regulated by the SEC. Producers selling variable products must have a securities license in addition to a life insurance producer license.

- Accumulation Units: When a contract owner pays premiums into the separate account, he is purchasing accumulation units. The separate account has a certain total number of accumulation units. The value of each accumulation unit can be calculated by dividing the value in the separate account by the insurer’s total number of accumulation units. The number of accumulation units a contract owner has directly correlates to what portion of the separate account the contract owner owns.

- Annuity Units: During the annuity phase, annuity units are used in lieu of accumulation units to determine the amount of each annuity payment. The number of annuity units is fixed and is based on the contract's dollar value investment in the separate account, and how much the first annuity payment will be.

4. Indexed

Equity Indexed Annuities are fixed annuities that provide a guaranteed minimum interest rate.

E. Combination plans and variations

1. Joint life

Joint life insurance policies insure the lives of two or more people. Premiums for joint life policies are less expensive than if each life was insured on a separate policy.

First-to-die Joint Life: Policy that pays the face amount upon the first insured's death. After the first insured dies, the contract does not provide any further life insurance coverage.

2. Survivorship life (second to die)

Survivorship Life: A type of joint life policy where policy proceeds are only paid out upon the death of the second insured.

POLICY RIDERS, PROVISIONS, OPTIONS, AND EXCLUSIONS

In life insurance, there are no "standard" policies; however, states have made an effort to standardize provisions recommended by the NAIC. Life insurance provisions, options, and riders make each life insurance policy unique. ***Provisions*** are the characteristics, privileges, duties of all parties, and rights of a policy. ***Options*** involve how policy funds are utilized. ***Riders*** are policy elements that "ride on" or add to the existing coverage by modifying provisions or coverage.

The following chart provides a summary of the various policy provisions, options, and riders.

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Life Insurance Topics

Policy Provisions, Options and Riders

Provisions	Options	Riders
Rights (Protect Policy Owner)	*Choices on How to Distribute a Sum of Money*	*Add or Modify Coverage (Customize)*
Rights of Ownership	*Divided Options*	*Guaranteed Insurability Rider*
Standard Provisions	*Nonforfeiture Options*	*Waiver of Premium Rider*
Entire Contract	*Settlement Options*	*Automatic Premium Loan*
Insuring Clause		*Payor Provisions Rider*
Free-Look		*Accidental Death Benefit*
Consideration		*Return of Premium Rider*
Grace Period		*Cost of Living*
Reinstatement		*Other Insureds Rider*
Policy Loan		
Incontestable		
Assignment		
Accelerated Benefits		
Suicide Provisions		
Misstatement of Age/Sex		
Automatic Premium Loan		

A. Policy riders

Another name for policy riders is policy add-ons. Life insurance policies can be customized by adding policy riders or endorsements to meet the specific needs of a client. While a policy rider adds additional benefits to a life insurance policy, it also usually raises the premium amount.

1. Waiver of premium rider: Allows the policyowner to waive premium payments during a disability, and keeps the policy in force. The disability must be total and permanent. After a certain age (usually 60 or 65), the waiver of premium rider is void.

2. Guaranteed insurability: Permits the policyowner to buy additional permanent life insurance coverage at specific points in time in the future (i.e. marriage, births, etc.) without requiring the insured to provide proof of insurability.

3. Payor benefit: If the individual paying the premiums on a juvenile life policy becomes disabled or dies before the insured child reaches a certain age, such as 21, the policy premiums will be waived until the child reaches the specified age.

4. Accidental death and/or accidental death and dismemberment: May be added to a life insurance policy. Pays benefits for dismemberment and accidental death. Pays a principal sum for loss of both hands, both arms, both legs, or loss

of vision in both eyes.

5. Term riders: Adds term coverage to an existing life insurance policy.

6. Other insureds (e.g., spouse, children, nonfamily): Riders can be attached to protect the insured's spouse, children, or both.

7. Long term care: A type of accelerated benefit, which is used to pay long-term care costs.

8. Return of premium: Rider pays the total amount of premiums paid into the policy as long as the insured dies within a certain time period specified in the policy.

B. Policy provisions and options

Policy provisions are conditions or clauses that identify the rights and obligations of the parties in a contract. In other words, policy provisions are the rules which direct how the two parties must plan the game of Life Insurance.

1. Entire contract: The insurance policy itself (including any riders and endorsements/amendments) and the application, if attached to the policy, comprise the entire contract between all parties. Insurance producers cannot make changes to a policy. Only an authorized officer of the insurer is permitted to make changes to the contract.

2. Insuring clause: The insurer's basic promise to pay benefits in the event of a covered loss.

3. Free look: The policyowner is permitted a number of days from the date the policy is delivered (usually 10) to look over the policy and return it, if dissatisfied for any reason, for a refund of all premiums paid.

4. Consideration: A policyowner must pay a premium in exchange for the insurer's promise to pay benefits.

5. Owner's rights: The ownership provision stipulates the rights of the policyowner.

6. Beneficiary designations

a. Primary and contingent: The policyowner may name up to three levels of prioritized beneficiaries: primary, contingent and tertiary. The beneficiaries at lower levels of priority (contingent and tertiary) do not receive policy proceeds unless the higher level(s) beneficiaries predecease the insured.

b. Revocable and irrevocable: The policyowner can change revocable beneficiaries without their consent. However, with irrevocable beneficiaries, the policyowner must receive their written consent to exercise any ownership rights except for the right to pay premiums.

c. Changes: The policyowner can change beneficiaries at any time without their consent as long as they are named as revocable. The policyowner must receive the irrevocable beneficiary's written consent to change a beneficiary. The policyowner may request a change to the named beneficiary either:

- By filing (contacting the insurer via phone or in writing and requesting the change – the *recording method*); or
- By an endorsement (changing the policy itself to indicate the change in beneficiary).

It is important to note that the changing of a designated beneficiary cannot be done through a will. In addition to a change in revocable beneficiary, the owner of a life insurance policy also has the power to make a policy loan or surrender the policy for its cash value, without the beneficiary's consent. However, the policyowner may not increase the amount of the insurance without the beneficiary's consent.

d. Common disaster: It protects contingent beneficiaries' rights by stipulating a certain number of days the primary beneficiary must outlive the insured after a common accident causing near-simultaneous death in order for the primary beneficiary to receive the policy proceeds; otherwise, the contingent beneficiaries receive the policy proceeds. If the primary beneficiary dies before the insured, then the policy proceeds are paid to the contingent beneficiaries, or if none, to the insured's estate. If the insured dies before the primary beneficiary, then the policy proceeds are paid to the primary beneficiary only if he outlives the insured by the specified number of days. The stipulated period is usually 15 or 30 days.

e. Minor beneficiaries: A minor can be named as a beneficiary, but because a minor cannot legally receive policy proceeds, a guardian or trustee must be appointed who can legally receive the policy proceeds and manage them until the minor reaches the legal age. A trust can be established if a guardian cannot be relied upon to manage the funds. Insurance companies may make restricted life payments to an adult guardian on behalf of the minor beneficiary. The insurer may also keep the policy proceeds to accrue interest until they may be paid to the minor when he or she reaches the age of majority or when an adult guardian has been appointed. Finally, the insurer may put the policy proceeds in a trust on behalf of the minor.

7. Premium Payment

a. Modes: The premium payment mode is the frequency that premium payments are made. Most insurers accept premium payments annually, semi-annually, quarterly, and monthly. Home service policies accept weekly premiums.

b. Grace period: The stipulated period of time policyowners are allotted to pay an overdue premium during which the policy remains in force.

c. Automatic premium loan: Allows the insurer to automatically use the policy cash value to pay an overdue premium.

d. Level or flexible: Life insurance premium payments can be level or flexible. Level premiums remain constant, while flexible premiums can vary in amount or frequency.

8. Reinstatement: Permits the policyowner to reinstate a policy that has lapsed, as long as the policyowner can provide proof of insurability.

9. Policy loans, withdrawals, partial surrenders: Policies that permit cash value have policy loan and withdrawal provisions. These policies must begin to build cash value after a certain number of years. In most states, this is 3 years. The policyowner has the right to the policy's cash value. Policy loans are not taxable.

- **Cash Loan**: Policyowners can make a policy loan in an amount up to the current cash value, less any existing indebtedness (prior loans with interest).
- **Automatic Premium Loans**: Allows the insurer to automatically use the policy cash value to pay an overdue premium.
- **Withdrawals or Partial Surrenders**: Withdrawals or partial surrenders of policy cash value can be made from universal life policies.
- **Modifications:** Policy changes must be made by an authorized officer of the insurer and attached to the policy. Only the policyowner has the right to request changes.
- **Medical Examination and Autopsy**: Require the proposed insured to undergo a medical examination prior to issuing coverage at the insurer's expense if necessary, such as for large amounts of coverage. Provision grants right of autopsy to insurer, at the insurer's expense.
- **Excess interest provision**: When a life insurance policy's interest rate becomes greater than the assumed interest rate, the policy will build excess cash value.

10. Non-forfeiture options: Nonforfeiture options/values are guarantees that are required by law to be part of life insurance policies that build cash value. Insurers are required to make nonforfeiture values available when policyowners discontinue premium payments for any reason.

- **Cash Surrender Value**: Allows the policyowner to receive the policy's cash value.
- **Extended Term Option:** Permits the policyowner to use the policy's cash values to buy paid-up term insurance.
- **Reduced Paid-up Insurance Option:** Allows the policyowner to purchase paid-up whole life coverage at a reduced face amount based on the amount of the policy cash value. No more premium payments are made.

11. Dividends and dividend options: Though not guaranteed, participating policies pay dividends to policyowners. Recall that dividends are a return of overcharged premium, and are therefore not taxable. Insurers typically pay dividends on an annual basis. Dividend options are the choices available to policyowners for settling dividend payment.

- **Cash Payment Option**: The policyowner receives a check for the amount of the dividend.
- **Reduction of Premium Payments Optio**n: Allows the policyowner to use the

dividend to offset the cost of a future premium payment.

- **Accumulation at Interest Option:** Allows the insurer to retain the dividend to be invested and grow in value.
- **One-year Term Option:** Allows the policyowner to use the dividend as a single premium to purchase one-year term protection
- **Paid-up Additions Option:** Allows the policyowner to use the dividend as a single premium to purchase an additional amount of whole life coverage.
- **Paid-up Insurance Option:** Allows the policyowner to use dividends to pay up the policy earlier.

12. Incontestability: Prevents the insurer from denying a claim or voiding a life insurance policy, except for nonpayment of premiums, after the policy has been in force for a certain number of years, usually 2.

13. Assignments: The right to transfer policy rights to another person or entity. An absolute or complete assignment occurs when the policyowner assigns all rights including cash values to another person or entity.

14. Suicide: The policy will be voided and no death benefit will be paid if the insured commits suicide within a stipulated time period, usually 1 or 2 years from policy issuance.

15. Misstatement of age and gender: Allows the insurer to adjust the policy benefits if the insured's age or sex is misstated on the policy application.

16. Settlement options: Settlement options are the ways that life insurance policy proceeds are paid out to beneficiaries upon the insured's death or when the policy endows. Settlement options allow the policy proceeds to be retained by the insurer and paid out gradually.

- **Lump-Sum:** One cash payment.
- **Interest Only**: The insurer retains the policy proceeds, which become the principal, and pays out only the growth on the principal to the beneficiary on a scheduled basis.
- **Fixed-period** or **Period Certain**: Installment option that uses an annuity to pay the policy proceeds to the beneficiary for a certain number of years.
- **Fixed-amount Installment Option:** Uses an annuity to pay the policy proceeds, but the payment amount is specified instead of period of time.
- **Life Income:** Option that uses an annuity to pay the policy proceeds. The beneficiary is provided with income that cannot be outlived: income is guaranteed for the beneficiary's entire life.
- **Straight Life** or **Single Life**: Pays the beneficiary periodic income for his entire life. Once the beneficiary dies, the payments stop, and any balance of principal is forfeited to the insurer.
- **Refund Life Option:** Pays the beneficiary periodic income for his entire life. If the beneficiary dies before the policy proceeds have been paid out entirely, then a second beneficiary receives the payments until the principal reaches zero. The refund life option provides a guarantee that the minimum benefit will be paid out.
- **Life Income Certain Option:** Pays periodic payments to a beneficiary for his entire life. If the beneficiary dies before a specified period in the policy has passed (such as 10 or 15 years), then a second beneficiary will receive

payments until that period ends. The life income certain option provides the beneficiary with a guarantee that benefits will be paid for a minimum number of years.

- **Joint and Survivor Option:** Allows two or more individuals to receive income payments for their entire lives.

Settlement Options	
Cash Payment (Lump Sum)	*Not taxable to beneficiary*
Life Income	*Pays a guaranteed installment as long as the recipient lives. Principle is forfeited upon death*
Interest Only	*Temporary option until proceeds are paid out using one of the other settlement options*
Fixed-period Installments	*Depletes funds over a fixed period* *Example: $100,000* *10 years = $10,000/year* *20 years = $5,000/year*
Fixed-amount Installments	*Pays fixed amount until proceeds are exhausted* *Example: $100,000* *$5,000/year = 20 years* *$10,000/year = 10 years* *$20,000/year = 5 years*

17. Accelerated death benefits: Allows the insured to receive a portion of the death benefit prior to death if the insured has a terminal illness.

Here is a summary chart of policy options:

Dividend Options	**Nonforfeiture Options**	**Settlement Options**
Cash Payments	Reduced Paid-up	Cash Payment
Reduction of Premiums	Extended Term	Life Income
Accumulation at Interest	Cash Surrender Value	Interest Only
Paid-up Additions		Fixed-period Installments
One-Year Term		Fixed-amount Installments

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C. Policy exclusions

The policy exclusions section of the contract states what the insurer will not do, including the risks that the insurer will not cover. Policy exclusions are optional, and may be included in life insurance policies at the discretion of the insurer.
These provisions exclude or limit coverage and are intended to protect the insurer from adverse selection and misuse of policies.

Suicide Clause: The policy will be voided and no death benefit will be paid if the insured commits suicide within a stipulated time period, usually 1 or 2 years from policy issuance.

Aviation: The insurer will not pay the claim if the insured dies due to involvement with aviation, such as a military pilot flying a jet aircraft.

War or Military Service: The insurer will not pay the claim if the insured dies while in active military service or due to an act of war.

Status clause – the insurer will not pay the claim if the insured dies while in active military service.

Results clause – the insurer will not pay the claim if the insured dies due to an act of war.

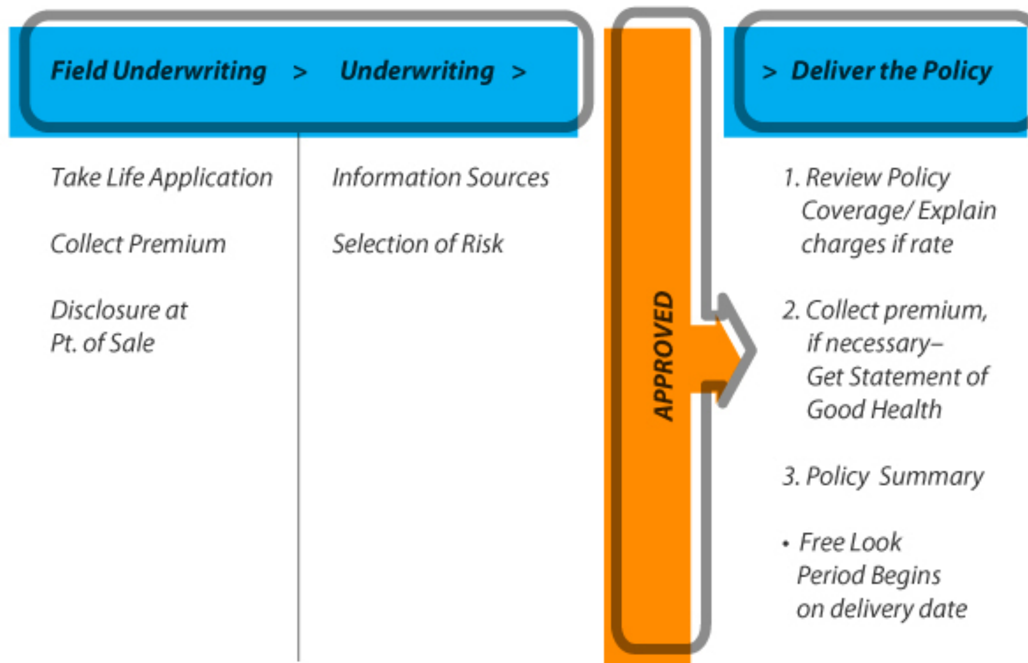
Hazardous Occupation or Hobby: If the insured dies as a result of a hazardous occupation or hobby, the insurer will not pay the claim.

COMPLETING THE APPLICATION, UNDERWRITING, AND DELIVERING THE POLICY

In this section we will cover the process involved with applying, issuing, and delivering insurance policies. The first step is completing the application. Next, the underwriting process helps determine the classification of risks and rates of the policy. And finally, we will look at the delivery of the policy.

Life Insurance Topics

Approval Process



A. Completing the application

The application is one of the primary sources of information used in underwriting an insurance policy. The person who applies for coverage must complete and submit the application. In most cases, the application is attached to, and becomes part of the contract. The application is attached to the policy so that it becomes a legal part of the insurance contract. Therefore, if the insurer discovers intentional misstatements in the application, the application can be used as a legal document.

1. Required signatures

The agent and the applicant are required to sign the application. If the applicant is someone other than the proposed insured, except for a minor child, the proposed insured must also sign the application (in some states once a minor reaches the age of 15, the minor is eligible to contract for a life or health insurance policy). It is important for the agent to be present to witness any and all signatures. Disclosure forms and additional questionnaires that the applicant must complete must be signed by both the agent and the applicant. If automatic checking account drafts will be used for premium payment, the applicant must sign agreeing to such.

2. Changes in the application

If an agent notices a minor error on the application, the producer should correct the information in the presence of the applicant and have the applicant initial the change. Changes should be struck through, not erased. If the agent notices a major error on the application, the agent should start a

new application for the prospective insured and safely dispose of the previous application.

3. Consequences of incomplete applications
If an agent notices that the application is incomplete, the agent should have the applicant fill in the incomplete sections and then submit the application to the insurer. If the insurer approves an incomplete application, then the insurer has waived its right and is legally estopped from reasserting the right.

4. Warranties and representations
Warranties are statements that are guaranteed to be true and are part of the legal contract. Breach of warranty is grounds for voiding an insurance contract. Representations are statements made by the insured, to the best of his knowledge.

5. Collecting the initial premium and issuing the receipt
Producers should make every effort to collect the initial premium with the application. The producer issues the applicant a premium receipt upon collecting the initial premium.

6. Replacement
Part 1 of the application includes information about existing policies if the proposed coverage is intended to replace existing coverage. If the agent discovers that the proposed coverage is replacing existing coverage, the policy is considered a replacement, meaning that the agent must comply with certain regulations regarding replacement.

7. Disclosures at point of sale (e.g., HIPAA, HIV consent)
Insurers are also permitted to request applicants undergo an HIV test as part of the application requirements, at the insurer's expense. Insureds must sign a consent form before the HIV test may be performed. Disclosures of privacy regulations must also be given to the applicant.

8. USA PATRIOT Act/anti-money laundering
The USA PATRIOT Act (Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001) gives more leeway to law enforcement agencies in searching the following records: email & telephone communications, medical, financial and foreign intelligence garnered within the U.S. The Act provides a means for preventing, detecting and prosecuting international money laundering (money laundering is concealing the origin of money – money that has been obtained illegally, such as through crimes, drug trafficking, etc.), especially money which is used to finance terrorism. The Act institutes more stringent record-keeping rules for financial institutions, such as requiring thorough records for transactions processed from parts of the world in which laundering is particularly a concern.

B. Underwriting

Underwriting is the process that insurance companies use to select, classify and rate risks. Insurance companies use the underwriting process to prevent adverse selection, which could cause the insurance company to become insolvent. Underwriting is used to classify risks and assign premium rates that accurately reflect the amount of risk undertaken by the insurance company. While the selection, rating, and classifying of

risks are part of the underwriting process, the notification of risks is NOT part of the underwriting process.

1. Insurable interest
For life insurance, insurable interest exists when the applicant financially prospers from the continued life of the insured, and the death of the insured would cause financial hardship. Insurable interest must be present when the policy is applied for; however, insurable interest does not need to exist thereafter. In either case, the death benefit will be paid.

There are three categories of insurable interest in life insurance:

- A person's own life
- The lives of relatives or spouses
- In business/financial relationships

2. Medical information and consumer reports
The Medical Information Bureau is a nonprofit trade organization which maintains medical information about individuals. Information from the MIB is used by life and health insurers. Member insurers supply the MIB with confidential aversive information about an applicant for insurability purposes. Information collected includes underwriting information such as an individual's hazardous activities and impairments to insurability; however, the MIB does not collect claims information or how much coverage an individual has. Insurers may access MIB information on an applicant only if needed for additional investigation. Insurers cannot refuse to issue policies solely on information supplied by the MIB.

Consumer Reports are any written, oral, or other communication of information by a consumer reporting agency about a consumer's credit worthiness, character, general reputation, personal characteristics or mode of living which are used to determine a consumer's eligibility for credit, insurance, employment, or other authorized purposes. The person seeking a consumer report on an individual must have a valid business need for the information.

Investigative Consumer Reports contain information on a consumer's character, general reputation, personal characteristics, or mode of living, but are obtained through personal interviews with neighbors, friends, or associates of the consumer. Investigative consumer reports cannot be performed unless the consumer has been notified in writing of the report within three days of when the report was initially requested.

3. Fair Credit Reporting Act

The Fair Credit Reporting Act (FCRA) was passed in 1970 with the purpose of regulating the way credit information is collected and used. The Act requires consumer reporting agencies to implement policies and procedures to preserve the confidentiality, accuracy, relevance, and appropriate utilization of consumer's private credit information. There are two types of reports insurance underwriters will utilize to obtain credit information about an

applicant:

- Consumer Reports and
- Investigative Consumer Reports.

Consumers must be informed that they have the right to request additional information about the report; such information must be provided to consumers within five days, if requested. Consumers must be informed at the time of application that a consumer report may be requested, regardless of whether a report is actually ordered or not. Consumers should also be informed that they have the right to request additional information about the report, such as the name of the company that provided them with a report.

4. Risk classification
Underwriters use the following rating classification system to categorize the favorability of a given risk: preferred, standard, substandard, and declined.

- **Preferred:** Individuals who are above average in terms of physical condition and lifestyle and present a less than average risk to the insurer.
- **Standard:** Individuals in average physical condition with average lifestyles and habits.
- **Substandard:** Higher risks, due to the applicant's physical condition, disease history, hazardous occupation or dangerous hobbies or habits.
- **Declined:** Risks that are uninsurable because the applicant is too risky for an insurer to provide coverage.

5. Stranger-originated life insurance (STOLI)
In Stranger-originated Life Insurance, or STOLI, a consumer purchases a life insurance policy with the agreement that a third party agent/broker or investor will purchase the consumer's policy and receive the proceeds as a profit upon the consumer's death. The stranger may purchase the policy, naming themself as beneficiary, or use it for resale to an investor. Upon the insured's death, the stranger or investor receives the policy proceeds. The insured receives some sort of small financial benefit in this arrangement.

Under STOLI arrangements, the insured is usually a person who is either elderly (typically ages 65 to 85) or terminally ill. STOLI arrangements are used to make a profit on these individuals who are near death. In a sense, it is gambling on a person's life because the stranger or investor is betting the insured will die before they pay out a lot of money in premiums.

6. Investor-originated life insurance (IOLI)
Investor-originated life insurance (IOLI) is a type of STOLI. With IOLI, investors solicit elderly people to purchase life insurance, and an agent or broker agrees to loan insureds money to pay the premiums for a period of time, with the agreement that after two years of paying premiums the investors become the policyowners, and receive the policy death benefits upon the insured's death. Investors supply funds to a "pool" of STOLI-type policies with the expectation that the insureds die very soon, so that they earn a profit on the death benefit.

In most cases, the lender is the investor, who uses the STOLI policy as collateral on the loan. If the insured dies during the 2-year loan period, the

investor/stranger repays the loan and then receives the death benefit. If the insured is alive after the 2-year loan period, the policy is sold to investors in an amount that is greater than the policy's cash value, but less than its death benefit. In exchange, the insured receives a nominal lumpsum payment for essentially facilitating a third party's profit upon their upcoming death.

STOLI and IOLI are ethical dilemmas because the investor or stranger does not have insurable interest in the *continued life and wellbeing of the insured*. They want the insured to die very soon, so that they will receive the policy death benefits. Often times, once the policy has been sold to a stranger/investor, the insured will be contacted several times a year to see if he/she has died.

C. Delivering the policy

1. When coverage begins
A policy is delivered after the insurer approves the application and issues the policy for delivery. The policy does not take effect until the initial premium has been collected, the application approved, and the policy is issued and delivered. Some insurers require a Statement of Good Health to be signed and collected from the insured, verifying that the insured has not become ill, injured, or disabled during the policy approval process.

The effective date of coverage is the date the policy coverage becomes effective and in force. The effective date of coverage is the date of the application as long as the premium accompanies the application, and the policy is approved as applied for. Otherwise, the effective date of coverage is the date the policy is delivered, the statement of good health signed (if required) and the premium collected.

2. Explaining the policy and its provisions, riders, exclusions, and ratings to the client
The applicant must receive a document explaining the coverage purchased and the names of the insurer and agent. In life insurance, this document is called the policy summary.

TAXES, RETIREMENT, AND OTHER INSURANCE CONCEPTS

A. Third-party ownership

In third-party ownership the three parties to the contract are the policyowner, insured and insurer. The policyowner must have an insurable interest in the life of the insured.

B. Group life insurance

Businesses, as well as individuals, buy life insurance for financial protection. Businesses purchase life insurance policies and annuities for a variety of reasons. One type of life insurance purchased by businesses is Group Life that is offered to employees to protect their family members and beneficiaries

Group life is differentiated from individual life in that enrollees typically:

- Do not have to provide evidence of insurability,
- Are not issued individual policies

- Do not own the contract.

1. Conversion privilege
Conversion to Individual Policy: If a member's coverage is terminated, the member and his dependents may convert their group coverage to individual whole life coverage, without having to show proof of insurability.

Conversion Period: An individual must apply for individual coverage within 31 days after the date of group coverage termination. An individual is covered under the group policy during the conversion period.

Group Policy Termination: If the master policy is terminated, each individual member who has been insured for at least 5 years is permitted to convert to an individual policy, providing coverage equal to the face value of the group policy.

2. Contributory vs. noncontributory
Group insurance premiums may be paid in two ways:

- **Contributory:** Contributory is where the premiums are paid jointly by the policyowner and insured. Contributory plans require **75%** participation of the group's eligible employees.
- **Noncontributory:** Noncontributory is where the premiums are paid entirely by the policyholder. Noncontributory plans require **100%** of the group's eligible employees to participate.

C. Retirement plans

Retirement plans are tools that help people save money for their non-working years. Retirement plans are important to employers because they attract good employees and help employees remain financially stable in retirement. However, one non-tax advantage to retirement plans for employees, but not for employers, is forced savings.

1. Tax-qualified plans
Qualified plans are retirement plans for the exclusive benefit of employees and beneficiaries. Qualified plans provide tax benefits and must be approved by the IRS. The plans must be permanent, in writing, communicated to employees, defined contributions or benefits, and cannot favor highly paid employees, executives, or stockholders. The primary type of qualified plans includes defined benefit and defined contribution plans.

Qualified plans have the following features:

- Employer's contributions are tax-deductible as a business expense.
- Employee contributions are made with pretax dollars - contributions are not taxed until withdrawn.
- Interest earned on contributions is tax-deferred until withdrawn upon retirement

Tax Benefits of Qualified Plans

Employer's contributions are tax-deductible and not treated as taxable income

to the employee. Employee contributions are made with pre-tax dollars, and any interest earned on both employer and employee contributions are tax-deferred. Employees only pay taxes on amounts at the time of withdrawal.

Withdrawals and Taxation

Withdrawals by the employee are treated as taxable income. Withdrawals by the employee made prior to age **59 ½** are assessed an additional 10% penalty tax. Withdrawals are mandatory at age **70 ½**, and failure to take the required withdrawal results in a 50% tax on those funds.

Funds may be withdrawn prior to the employee reaching age 59 ½ without the 10% penalty tax, if the employee dies or becomes disabled, a loan is taken on the plan's proceeds, the withdrawal is the result of a divorce proceeding, the withdrawal is made to a qualified rollover plan, or the employee elects to receive annual level payments for the remainder of his life.

2. Nonqualified plans

Nonqualified plans are used just as frequently as qualified plans, despite the fact that they do not have the tax advantages of qualified plans. Nonqualified plans permit employers to offer retirement plans only to their key employees. Common nonqualified plans for retirement include:

- split dollar plans,
- deferred compensation, and
- executive bonus plans.

There are numerous other types of nonqualified plans - such as a personal savings account or an individual deferred annuity. Nonqualified plans are characterized by the following:

- Do not need to be approved by the IRS
- Can discriminate in favor of certain employees
- Contributions are not tax-deductible
- Interest earned on contributions is tax-deferred until withdrawn upon retirement

D. Life insurance needs analysis/suitability

1. Personal insurance needs

Survivor Protection–One of the most common reasons for purchasing life insurance is to provide financial protection for family and dependents if the insured dies. The death of either spouse can strain the financial stability of a family. Life insurance can provide a family with a stream of income to fulfill the family's basic necessities of life and current lifestyle. These needs include: mortgage payments, living expenses, children's education, health insurance, and surviving spouse's retirement income.

Estate Creation–Life insurance creates an immediate estate. Estates may be created in other ways, such as through savings and investments, but if such methods are not effective or time does not permit, life insurance can assume the role of estate creation. For example, an investment fund may take years to grow;

whereas, a life insurance policy purchased today creates an immediate estate in a minimum amount of at least the initial premium.

Cash Accumulation-Life insurance policies that build cash value (whole life policies) may be used as a cash accumulation vehicle for any number of purposes. A life insurance policy that builds cash value is said to have living benefits. Some common purposes for accumulating cash include funding a college education, saving for retirement, or purchasing a home.

2. Business insurance needs
Buy-Sell Funding is life insurance funded agreements used to assure that the ownership of the business is sold to the surviving owners in the event of the insured employee's death or disability.

Key Person Insurance is Insurance purchased to prevent the financial loss that may ensue when an owner, officer or manager dies. The company purchases, pays the premiums and is the beneficiary of the life insurance policy on the key person. The amount of coverage needed reflects the expected amount of loss in income and sales caused by the key person's death, and the cost of hiring and training a replacement. The company cannot deduct the premiums from taxes; however, the death benefit is received tax free.

Employee Benefit Plans are given to employees as perks or privileges designed to provide incentive to join or remain with the company long-term. A few examples are: Executive Bonus Plans, Deferred Compensations Plans and Split Dollar Plans.

E. Social Security benefits and taxes
Social Security also known as Old Age, Survivors, and Disability Insurance (OASDI) was enacted by FDR in 1935. It provides benefits for most workers upon unemployment, disability, old age, or death.

Social Security benefit eligibility is based on the individual's insured status. Social Security has three types of insured status: fully, currently, and disability. The insured status is based on the quarters of credit earned, based on quarters of the year in which the individual worked and earned a minimum wage. Quarters are counted cumulatively, and do not have to be earned consecutively.

1. Fully Insured

To be eligible for all Social Security benefits, an individual must be fully insured, or earn at least 40 quarters of credit prior to age 62, the year of disability, or the year prior to death. Once a person earns at least 40 quarters of credit, the person is fully insured for the person's entire life.

2. Currently Insured

To be eligible for partial Social Security benefits, an individual must be currently insured, or earn at least 6 quarters of credit within the past 13 quarters. Currently insured person's partial benefits increase based on the number of quarters of credit earned.

3. Disability Insured

Life Insurance Topics

Eligibility for Social Security disability benefits is based on the "recent work test." Individuals must earn minimum quarters of credit within a period of time based on the individual's age. The minimum quarters of credit within a time period are:

- **6 quarters (1.5 years)** of credit within the past three years for individuals under the age 24
- **10 quarters (2.5 years)** of credit within the past five years for individuals under the age 31
- **20 quarters (5 years)** of credit within the past 10 years for individuals over age 31

Primary Insurance Amount

The primary insurance amount (PIA) is the average monthly wage of an individual and is used in determining the amount of the individual's Social Security retirement benefits.

Retirement Age

The full retirement age is 65 for covered workers who were born in 1937 or earlier. The full retirement age increases for individuals born between the years of 1938 to 1959 with the maximum retirement age set at age 67 for covered workers who were born in 1960 or later. The earliest age that an individual can receive Social Security retirement benefits is 62. The amount of the benefit will be lower than if the individual waited until his/her normal retirement.

Dual Benefit Eligibility

If an individual is eligible for dual Social Security benefits, the individual will receive the greater of the benefits, but not both.

Maximum Family Benefit for Survivors and Disability

A limit is placed on how much a covered worker and his family receives for Social Security survivors and disability benefits. The limit is indexed annually.

Earning Limits for Retirement

Once an individual reaches normal retirement age, the person is entitled to Social Security retirement benefits, whether or not the individual continues to work. However, if an individual elects to receive retirement benefits prior to attaining normal retirement age, the individual may be limited by the amount of money the person can earn without further reduction of benefits.

Social Security Benefits

Social Security benefits include several different types. The main benefits include: survivor, disability, and retirement benefits.

- **Survivor Benefits:** Survivor benefits pay a lump-sum death benefit or monthly income to survivors of deceased covered workers.
  Blackout Period: The Social Security blackout period is the time when the surviving spouse is ineligible to receive benefits. After the blackout period, the

spouse is ineligible for survivor benefits until age 60.

- **Disability Benefits:** Social Security disability benefits are only available to covered persons who are fully and disability insured. Disability benefits begin after a five-month waiting period. Disability benefits are only available until age 65. The person must be unable to perform work done prior to disability due to physical and mental conditions that have or will last at least 12 months or result in death. Social Security does not pay partial or short-term disability benefits.
- **Retirement Benefits:** Social Security retirement benefits are only available to covered workers who are fully insured upon retirement. If a covered worker retires at the normal retirement age, he will receive 100% of the PIA. However, if a covered worker retires early at the age of 62, the maximum Social Security benefit is 80% of the PIA. This reduction remains all through retirement. Retirement benefits pay covered retired workers at least 62 years of age, their spouses and other eligible dependents monthly retirement income.

Social Security Payroll Taxes: Social Security payroll taxes are collected from employers, employees and self-employed individuals.

Taxation of Social Security Benefits: Social Security benefit payments may be taxable if the individual's income is greater than a certain amount.

F. Tax treatment of insurance premiums, proceeds, and dividends

As a general rule, premiums for life insurance policies are not tax-deductible and proceeds from life insurance policies are tax-free if received in a lump sum. If proceeds are received in installments, a portion of the proceeds will contain interest, which is taxable.

1. Individual life

- **Premiums** for individually-purchased life insurance are not tax-deductible.
- **Death benefits** are tax-free if received in a lump-sum.
- **Interest:** If the benefit is paid in installments, the portion that is interest on the benefit is taxable. The cash value of a life insurance policy increases upon payment of premiums and interest accrued. If the policy is surrendered for cash value, the amount of interest is taxable. Otherwise, the benefit is tax-free.
- **Dividends** are considered a return of overcharged premium, and are not taxable since premiums are paid with after-tax dollars.
- **Loans** taken against the policy are repaid or recovered upon policy surrender or maturity, and are not taxable. If the policy is surrendered, the amount of cash value greater than premiums paid is taxable as income.
- **Accelerated benefits** are tax-free as long as the distribution is qualified, meaning the insured is terminally ill or expected to die within two years. Transfer of value occurs when the policy is sold to another party for consideration. While benefits are generally tax-free, if the policy's proceeds are a result of a transfer of value, the proceeds are taxable.

2. Group life

- Premiums paid by employees are not tax-deductible.
- The employer can deduct premium payments as a business expense.
- Proceeds are tax-free if received in a lump-sum.
- Benefits paid in installments are subject to taxation for the interest portion.

Life Insurance Topics

3. Modified Endowment Contracts (MECs)

MECs are overfunded life insurance policies and are subject to taxation. Congress and the IRS defined MECs to prevent individuals from using life insurance policies as investment vehicles simply to withdraw tax-free proceeds through partial surrenders. To determine whether a policy is defined as life insurance or a MEC, the IRS uses the seven-pay test. The seven-pay test requires premiums paid in the first seven years of the policy not exceed the level annual premium payments for a seven year paid-up policy, or the policy is defined as a MEC. MECs tax withdrawals on a last in, first out rule, which pays out interest first and is taxed as income. If withdrawals are made prior to age 59 ½, an additional 10% tax penalty is assessed, regardless of principal or interest. The death benefit is tax-free.

Life Taxation Overview

	Premiums	**Proceeds**
Individual	Not tax-deductible	Tax-free if received in a lump-sum
Group	Premiums paid by employees are not tax-deductible	Tax-free if received in a lump-sum
MECs	The seven-pay test requires premiums paid in the first seven years of the policy not exceed the level annual premium payments for a seven year paid-up policy, or the policy is defined as a MEC. MECs tax withdrawals on a last in, first out rule, which pays out interest first and is taxed as income. If withdrawals are made prior to age 59 ½, an additional 10% tax penalty is assessed	Tax-free