



# Insuring Your Life

## Chapter 8

# Learning Goals

**LG1**

Explain the concept of risk and the basics of insurance underwriting.

**LG2**

Discuss the primary reasons for life insurance and identify those who need coverage.

**LG3**

Calculate how much life insurance you need.

**LG4**

Distinguish among the various types of life insurance policies and describe their advantages and disadvantages.

**LG5**

Choose the best life insurance policy for your needs at the lowest cost.

**LG6**

Become familiar with the key features of life insurance policies.

# How Will This Affect Me?

- **Insurance should be used only to protect against potentially catastrophic losses, not for small-risk exposures. It should cover losses that could derail your family's future.** It balances the relatively small, certain loss of ongoing premiums against low-probability, high-cost risks. This chapter focuses on how to go about buying life insurance. Premature death is clearly a catastrophic loss that could endanger your family's financial future. We start by explaining how to determine the amount of life insurance that is right for you. We also consider how to choose among key insurance products, which include term life, whole life, universal life, variable life, and group life policies. The key features of life insurance contracts are explained, and frameworks for choosing an insurance agent and an insurance company are presented. The chapter should prepare you to make informed life insurance decisions.



# ***Financial Facts or Fantasies?***

- The best way to figure out how much life insurance you need is to use a multiple of your earnings.
- Social security survivor's benefits should be factored into your life insurance plans if you have a dependent spouse and/or minor children.
- Term insurance provides nothing more than a stipulated amount of death benefits and, as a result, is considered the purest form of life insurance.
- Selecting an insurance company is the first thing you should do when buying life insurance.
- Because most life insurance policies are largely the same, you need not concern yourself with differences in specific contract provisions.



# Purpose of Life Insurance

- ▶ to protect you and your family from the financial consequences of losing assets or income when an accident, illness, or death occurs



# Basic Concept of insurance is RISK

- Risk is defined as uncertainty concerning a potential economic loss
- The simplest way to deal with risk is to avoid the act that creates it.
- Risk Avoidance: avoiding an act what would create a risk.
- There is RISK in everything you have a financial interest
- Life, Health, Home, Car, Business, Everything



# Living with Risk

- Unless you live in a bubble, you have to assume risk
- Risk assumption: The choice to accept and bear the risk of loss.
- Loss Control is any activity that lessen the severity of loss once it occurs, wear seat belts, don't drink and drive, eat a healthy diet, no smoking
- Insurance: You transfer some of your risk of loss to the insurance company.
- **But you cannot transfer 100% of risk—your actions matter.**



# Underwriting Basics

- ▶ Insurance company decides whom to insure and rate to be charged
- ▶ Company must guard against adverse selection—a disproportionate number of bad risks.
- ▶ A significant problem facing underwriters is how to determine the criteria for classifying the people that they choose to insure. Criteria will vary between companies—you need to shop around to find best policy for you.





# Benefits of Life Insurance

- Financial protection for dependents—people who rely on you for financial resources
- Protection from liability—Able to pay off mortgage
- Tax benefits—proceeds from life insurance not taxable
- Vehicle for savings, though not the best vehicle



# Do You Need Life Insurance?

- **Yes IF:**

- Dependents count on your financial support
- You have debts such as home mortgage

- **NO IF:**

- No one depends on you for support
- You are a child

- **Maybe yes** for funeral costs and other end of life expenses



# How Much Life Insurance?

- Two methods:
- **Multiple-of-Earnings**
  - Multiply annual earnings by an arbitrary number, rule of thumb 5 to 10 times annual take-home pay
- **Needs Analysis**
  - Estimate needs and examine available resources

# How Much Life Insurance?

## Needs Analysis Worksheet 8.1

**Step 1:  
Assess your family's  
total economic needs**

- Income needed to maintain an adequate lifestyle
- Extra expenses if the income producer dies
- Special needs of dependents
- Debt liquidation
- Liquidity

minus

**Step 2:  
Determine what  
financial resources will  
be available after death**

- Savings and investments
- Income from Social Security survivor's benefits; surviving spouse's annual income; other annual pensions and profit-sharing programs
- Other life insurance
- Other resources

equals

**Step 3:  
Amount of additional  
life insurance required  
to protect your family**



# Term Life Insurance

- Specified amount of insurance protection for a set period of time
- Benefit paid if insured dies during that time; otherwise no benefit paid
- Simplest type of insurance policy



# Types of Term Insurance

- **Straight Term**
  - Coverage remains the same while premiums can increase as insured ages
- **Decreasing term**
  - Premiums remain the same while coverage decreases



# Important Features of Term Insurance

- Renewability
  - Ability to renew policy without evidence of insurability
- Convertibility
  - Convert to whole life policy without evidence of insurability

# Representative Renewable Term Life Insurance Premiums, Nonsmoker, \$100,000

Age	10 Year	15 Year	20 Year	30 Year
	Male/Female	Male/Female	Male/Female	Male/Female
25	\$106/\$102	\$116/\$110	\$128/\$116	\$161/\$143
35	108/\$102	117/\$112	134/\$125	175/\$152
40	122/\$115	135/\$129	157/\$145	222/\$185
50	203/\$171	250/\$199	298/\$233	475/\$341
60	403/\$300	539/\$373	669/\$502	Not available





# Term Insurance

- Advantages:

- Economical way for young families to purchase large amounts of life insurance
- Provides for needs that disappear over time

- Disadvantages

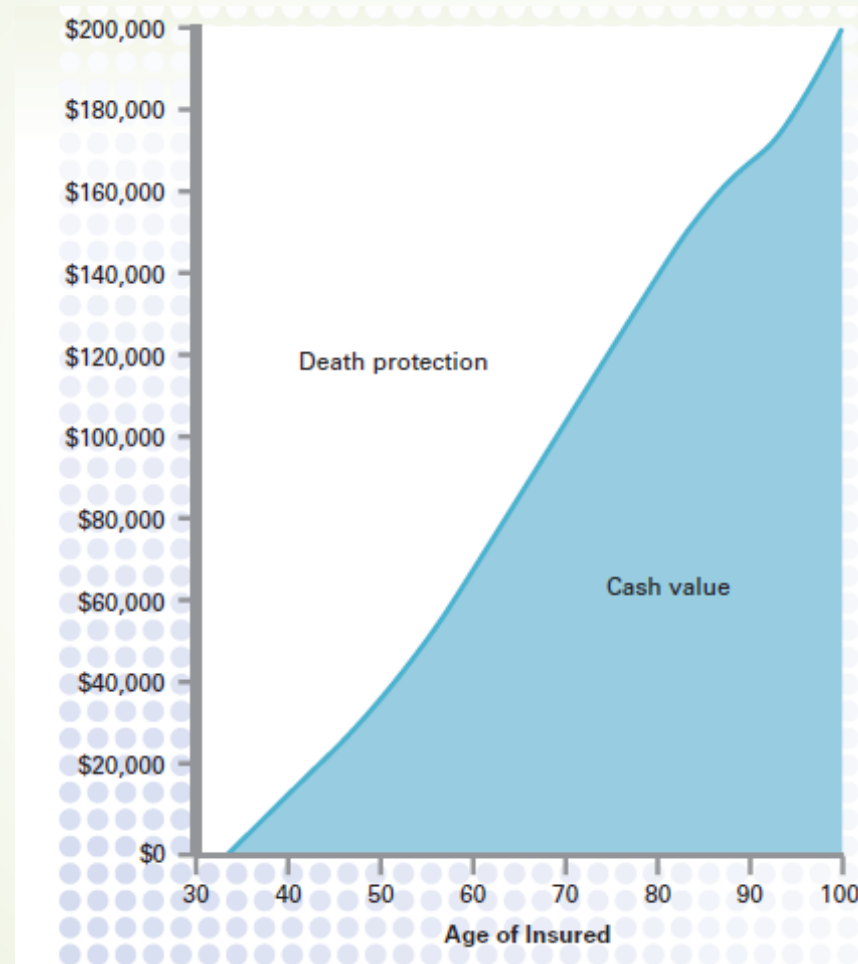
- Premiums become too costly as you get older
- Does not build cash value



# Whole Life Insurance

- Provides insurance during individual's entire life – Permanent insurance
- Cash value
  - Provides death protection plus a savings feature
- Nonforfeiture right
  - Right to cash value when canceled prior to death

# Cash value and Death Protection



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# Representative Whole Life Premiums \$100,000, Nonsmoker

Age	Annual Premium		Premiums Paid through Year 20		Total Cash Value at Year 20*	Paid-Up Insurance at Year 20	
	Male	Female	Male	Female	Male/Female	Male	Female
25	\$603	\$525	\$12,060	\$10,580	\$10,670	\$55,700	\$56,200
30	727	683	14,540	12,760	13,518	57,500	58,600
35	891	775	17,820	15,500	16,908	58,900	60,600
40	1,078	931	21,560	18,620	20,518	60,000	62,300
50	1,590	1,367	31,800	27,340	29,796	62,300	65,300
60	2,418	2,050	48,360	41,000	41,796	66,260	68,800



# Types of Whole Life Policies

- ▶ Continuous Premium (straight life) – Level premiums paid until death or policy cancellation
- ▶ Limited payment – Level premiums paid for specified number of years, insurance in force until death
- ▶ Single premium – Lifetime coverage purchased with a single premium



# Advantages of Whole Life

- Savings vehicle
- Borrow against cash value
- Premiums remain constant
- Cash value accumulates tax-free until redeemed



# Disadvantages of Whole Life

- ▶ Less death protection for young people
- ▶ Low return on savings
- ▶ Tax penalties possible on early withdrawal
- ▶ Outstanding loan subtracted from face value of policy upon death



# Universal Life Insurance

- Permanent cash-value insurance that combines term insurance with tax sheltered saving account
- Provides death protection plus savings feature
- Premiums are unbundled into 2 accounts
- Savings grow at current interest rate v guaranteed minimum rate
- Provide flexibility in premiums paid and death benefit



# Representative Universal Life Premiums

Age	Annual Outlay		Premiums Paid through Year 20		Cash Surrender Value at Year 20*	
	Male	Female	Male	Female	Male	Female
25	\$701	\$628	\$14,027	\$12,574	\$16,206	\$14,495
30	830	742	16,590	14,833	19,480	17,302
35	995	885	19,896	17,702	23,169	20,481
40	1,205	1,067	24,108	21,340	27,366	24,234
50	1,806	1,579	36,127	31,573	38,468	34,368
60	2,808	2,402	56,155	48,034	56,365	47,912

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# Variable Life Insurance

- Provides death protection plus a savings or cash value feature
- Cash value can be invested in mutual funds for greater possible return
- Returns not guaranteed and actual death benefit can vary

# Representative Variable Life Premiums

Policy Year	Total Premiums Paid	6% Return		12% Return	
		Cash Value	Death Benefit	Cash Value	Death Benefit
1	\$1,575	\$995	\$100,995	\$1,064	\$101,064
5	8,705	5,244	105,244	5,705	105,705
10	19,810	10,592	110,592	15,365	115,365
15	33,986	15,093	115,093	27,688	127,688
20	52,079	17,080	117,080	43,912	143,912



# Other Types of Life Insurance

- ▶ Variable Life Insurance – Combines flexibility of premium payment feature of universal with investment choices offered by variable
- ▶ Group Life Insurance – Usually term insurance offered through employers. Premiums usually lower than individually purchased policies



# Other Special-Purpose Life Insurance

- Credit and Mortgage Life Insurance
  - Decreasing term insurance
  - Pays off outstanding balance if borrower dies before repaid
  - Costly form of coverage
- Industrial Life Insurance
  - Whole life policies with small face amounts
  - For low-income families



# Buying Life Insurance

- Compare costs and features
- Select a large, highly rated, financially secure company that is assigned ratings by at least two of the major rating agencies and are consistently rated in the top two or three categories
- Choose a reputable agent

# Major Advantages and Disadvantages of Types of Life Insurance Policies

Type of Policy	Advantages	Disadvantages
Term	<ul style="list-style-type: none"> <li>Low Initial premiums</li> <li>Simple, easy to buy</li> </ul>	<ul style="list-style-type: none"> <li>Provides only temporary coverage for a set period.</li> <li>May have to pay higher premiums when policy is renewed.</li> </ul>
Whole life	<ul style="list-style-type: none"> <li>Permanent coverage</li> <li>Savings vehicle: cash value builds as premiums are paid</li> <li>Some tax advantages on accumulated earnings</li> </ul>	<ul style="list-style-type: none"> <li>Cost: provides less death protection per premium dollar than term.</li> <li>Often provides lower yields than other investment vehicles.</li> <li>Sales commissions and marketing expenses can increase costs of fully loaded policy.</li> </ul>
Universal life	<ul style="list-style-type: none"> <li>Permanent coverage</li> <li>Flexible: lets insured adapt level of protection and cost of premiums</li> <li>Savings vehicle: cash value builds at current rate of interest</li> <li>Savings and death protection identified separately</li> </ul>	<ul style="list-style-type: none"> <li>Can be difficult to evaluate true cost at time of purchase; insurance carrier may levy costly fees and charges</li> </ul>
Variable life	<ul style="list-style-type: none"> <li>Investment vehicle: insured decides how cash value will be invested</li> </ul>	<ul style="list-style-type: none"> <li>Higher risk</li> </ul>



# What type of Insurance for YOU?

- Common phrase among insurance agents:
- People buy term insurance; you have to sell whole life.
- A strategy:
- Buy term, invest the difference in premium between term and whole life





# Life Insurance Contract Features

- Beneficiary Clause
- Settlement options—lump sum, interest only, fixed period, fixed amount, and life income
- Policy loans
- Premium payments and Grace period
- Nonforfeiture options (paid-up insurance & extended term insurance)
- Policy reinstatement
- Change of policy



# Other Policy Features

- Multiple indemnity clause
- Disability clause
- Guaranteed purchase option
- Suicide clause
- Exclusions
- Participation
- Living benefits
- Viatical settlement



# Life Insurance Policy Illustrations

- ▶ A hypothetical representation of a life insurance policy's performance that reflects the most important assumptions that the insurance company relies on when presenting the policy results to a prospective client.