The QUESTIONS *and* ANSWERS *on* LIFE INSURANCE WORKBOOK

A STEP-BY-STEP GUIDE TO SIMPLE ANSWERS FOR YOUR COMPLEX QUESTIONS

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INTRODUCTION

Does the thought of life insurance give you a headache? Have you put off purchasing life insurance because you don't know how to get started? Are you unable to fully understand the life insurance policies you've acquired or that someone else obtained for you? If you answered yes to any or all of these questions, this workbook will help you solve your life insurance woes and may save you a significant amount of money.

I'll provide you with a step-by-step process for determining your life insurance needs, finding a good provider, getting a policy, and evaluating your policy quickly and effectively each year. In combination with *Questions and Answers on Life Insurance*, this workbook will help you take charge of your life insurance, understand it, and spot any potential issues before it is too late.

I've designed this book to help those just starting the process of looking for life insurance, those who already have a policy, and those who are helping others make life insurance decisions. If you're new to life insurance and don't yet have a policy, part I will guide you through the process of determining how much and what kind of life insurance you need, and part II will help you find the best provider. Note that I'm assuming you definitely need life insurance. If you haven't determined that yet, you can go to my website and use the "How Much Life Insurance Do I Need?" questionnaire to make sure you actually need it. Part III will teach you how to prepare yourself for the review process a year from now.

If you're someone who already owns a policy and knows something about life insurance, part I serves as an excellent and necessary opportunity to perform a gap analysis: How well do both the policy you purchased some years ago and your life insurance company meet your current needs? Your needs may have changed or you may not have done a thorough assessment of your needs when you first purchased your policy, instead relying on your life insurance agent's or financial adviser's advice. Part III will help you review and evaluate your current policy and your options. As with any other financial instrument, it is critical that you review your life insurance coverage annually, but few people understand how to do this quickly and effectively. If you no longer need coverage, I'll help you figure out options for terminating your policy.

And if you are responsible for helping others assess their life insurance needs as part of an overall estate-planning or financial-planning approach, this workbook can help you get to better answers faster.

The U.S. life insurance industry is huge, and it is not bargain oriented. You might compare it to a casino: Odds are involved, and insurance companies didn't get those big, shiny buildings by paying out more than they take in. Unlike gambling, life insurance is a critical part of most financial plans, which is why so many people need this type of guide. You need to get the biggest benefit from your life insurance dollars.

That is the goal of this book: to help you best utilize your life insurance dollars to get the best deal you can. Why pay more than you need to?

A life insurance policy is, at the end of the day, a tool for financial leverage—nothing more, nothing less. But this book is not about investing; it's about life insurance, and using life insurance as life insurance. If you want to invest your money to grow your nest egg or retirement funds, which by all means you should, look elsewhere. No matter what you read or hear, life insurance can serve as a supplemental investment only when you have a life insurance need. It is not an investing tool in and of itself because you will always have insurance charges on top of any other expenses.

Well, you may ask, what about the fact that life insurance cash values accumulate on a tax-deferred basis? First, this is not guaranteed. Congress consistently talks about revoking this feature of life insurance, and if it does, watch out. Second, other tax-deferred vehicles are available, such as IRAs, 401(k)s, and others, that Congress is not targeting for taxation and that do not have insurance charges. Unfortunately, many people are so concerned with the earnings that they ignore the impact of managing their expenses. It's the basis of any sound financial budgeting: Any time you lower expenses, your budget will improve.

So let's figure out the world of life insurance and how it fits into your overall planning.

DECISION CHART

PART I

Evaluate Your Needs and Situation

Step 1:
Determine your current need for life insurance: How much life insurance do you need? *Or* is your current life insurance enough?

Step 2:
Determine what type of life insurance you need: Do you need term or permanent/whole life insurance? *Or* is your current policy the right type to meet your current needs?

Step 3:
Assess your medical history and other factors that can affect your life insurance rates.

PART II

Evaluate Companies and Agents and Purchase a Policy

Step 4:
Evaluate life insurance companies and select one with which to work.

Step 5:
Choose an agent, adviser, or distributor.

Step 6:
Work with your agent to select the appropriate policy components and riders and purchase a policy.

PART III

Understand, Maintain, and Monitor Your Policy or Terminate It

Step 7:
Assess your policy to determine if it is living up to your expectations.

Step 8:
Determine whether replacing your policy makes sense.

Step 9:
If you no longer need your policy or are choosing to purchase a new policy, determine how to terminate/unwind the policy.

PART I

EVALUATE YOUR NEEDS AND SITUATION

STEP 1

Calculating Your Need for Life Insurance

For some people, life insurance seems easy to understand; however, it can be more complex than thought at first glance. For others—particularly those who don't know much about it—it might seem highly complex. In reality, it's neither simple nor complex, which is why the best path is to be a well-educated consumer. And the best place to start is not with a discussion of life insurance options but, instead, with a close look at your own needs. Answer the questions within this step the best you can, but don't worry about getting everything absolutely, inflexibly "right." This exercise isn't about perfection—no one can know the future for sure anyhow. This is about ball parking it. It's about taking a best guess. It's about considering where you are now, where you want to go, and where you want your loved ones to be in case the worst comes to pass. As Master Yoda would say: In motion the future is.

1 EXPLORING WHY YOU NEED LIFE INSURANCE

Following are a number of scenarios or life situations that support a need for life insurance. Put a check next to the descriptions below that best correspond to your needs for life insurance.

- ◯ 1. I'm a primary breadwinner for my family. I have young children and my family is absolutely **dependent on my income**. If I were to die tomorrow, they would be in big trouble.
- ◯ 2. I've got debt. I have mortgages, car loans, credit cards, student loans, or some other form of large, **significant debt** that I couldn't burden my family or cosigners with if I passed away tomorrow. It would break them.
- ◯ 3. I don't want to burden my family with the **costs of my funeral**.
- ◯ 4. I'm saving for my child's or children's **private school or college education**. If I passed away, the kind of education that I'd like to be able to provide my child or children would very well be out of reach.
- ◯ 5. I want to have an **emergency fund**.
- ◯ 6. I have a **special needs child** who absolutely depends on my income for his or her care, probably for the rest of his or her life.
- ◯ 7. I'm worried about **estate taxes**. I want my family to have liquidity upon my death to fund the estate tax liability.
- ◯ 8. I'd like to donate a sizable amount to charity once I pass, but I don't necessarily want to significantly reduce the amount of my estate donated to heirs.
- ◯ 9. I want to make sure my heirs each get an **equal share of my assets** when I pass away.
- ◯ 10. I've got assets that haven't been taxed yet (a tax-deferred retirement account, for instance), and I don't want my family to be burdened with those taxes, or for those taxes to reduce the benefit my family receives upon my death.
- ◯ 11. I'm in a second or third (or beyond) marriage or domestic partnership, and I'd like to provide my new partner with financial security; I want to avoid any conflict that may arise about my estate once I pass.

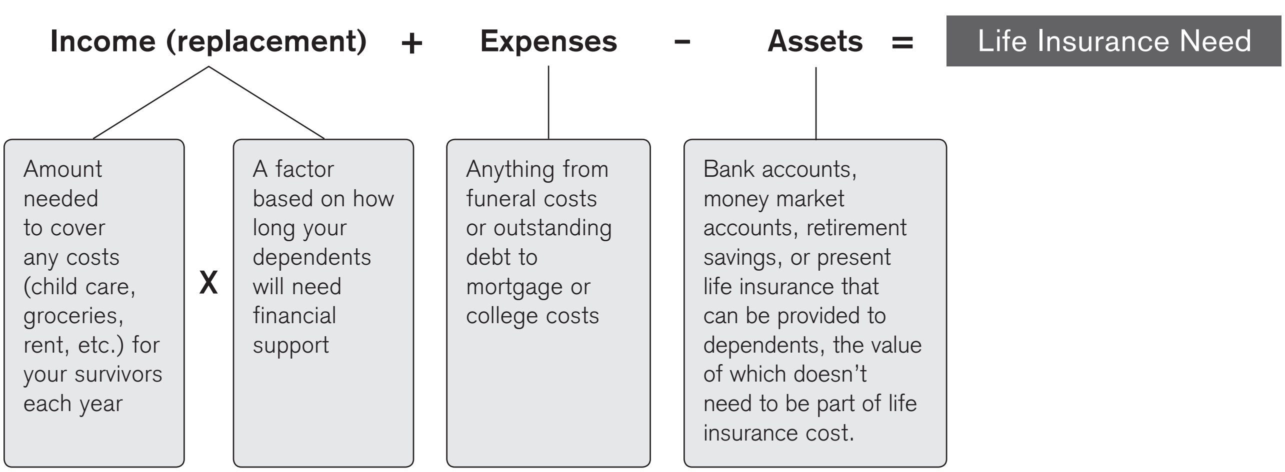
Looking at these scenarios, you can see that some are broader in context (the income-dependent ones) and some are much more specific (like the handling of estate taxes). Which scenarios best describe your situation will largely depend on how much in assets you have or can reasonably expect to have, what stage of life you're in, and your personal family situation. Although these aren't even all the reasons for purchasing life insurance, they do capture the most common motivations or reasons for purchasing it.

Use the space below to customize your responses to the reasons you just chose. How do those scenarios apply specifically to your own situation? Or what need do you have that is *not* listed here, and which previously mentioned category would it most closely resemble?

2 DETERMINING HOW MUCH LIFE INSURANCE YOU ACTUALLY NEED

Every adviser, financial columnist, and relative has a formula they think is best for determining how much life insurance you need. Some of these formulas are simple, whereas others look like something only a Wall Street numbers whiz could cook up. But don't let complexity overwhelm or discourage you. If your needs are more complex, a qualified life insurance agent or financial adviser can help you determine the right amount for you. For most people, however, the simplest methods are often the best. (We'll look at how you can find a great adviser in step 5.)

The simplest, most direct formula for determining how much life insurance you need is



The worksheet on the following pages will guide you through this equation. If you are interested in exploring other methods, information and resources can be found on my website at www.lifeinsurancetoolbook.com in the "How Much Life Insurance" section. Or you can refer to Question 3 in *Questions and Answers on Life Insurance*.

The best starting point for each of us in solving this equation is a simple, sound understanding of our own financial health. The more complicated we make it for ourselves, the better the chances are that something won't work out as planned. Life is beautiful and dynamic. Ultimately, life insurance isn't about reducing something as precious as life to numbers and figures; it's about freeing us up to focus on what really makes us happy.

Note that even though you may already own a policy, it's still important to complete this exercise. Why? Because your needs may have shifted as a result of certain milestones in life, such as having children, children graduating from college, retirement, changing careers, and so on.

For some people, this can be an emotional exercise. Just try to be as realistic about your financial health as you can be. The accuracy of any calculation depends on the information used. The more assets apart from life insurance you have, the more flexible your predictions about your life insurance needs can be. The fewer assets you have, the more you'll need a reasonable, actionable forecast of your financial future. Don't get hung up on the details you can't reasonably predict—again, this is about making best guesses. Some of the questions in the worksheet may not apply to you.

Before You Start: Social Security, College Expenses, and Life Expectancy

You will want to gather information before you begin filling out the worksheet. It is best to use current information, so go to my website (www.lifeinsurancetoolbook.com) or the websites mentioned below to collect the numbers you'll plug in on the worksheet.

Calculating Social Security benefits far into the future can get a bit tricky. But the Social Security Administration's website (www.SSA.gov) has an online estimator that can help with this task. Visit the website or get in touch with the Social Security Administration office to get an estimate of your current benefit amount.

Knowing how much college will cost is to some degree an uncertainty because it will depend on such factors as tuition, room and board, books, and related expenses. College costs are increasing almost twice as fast as the inflation rate. SmartMoney.com and CollegeBoard.com are two great sites to help you figure out how much you should plan to save for education.

Along with calculating future income and expenses, you will need to estimate your life expectancy. Refer to the mortality table in Question 3 in *Questions and Answers on Life Insurance* or on my website (www.lifeinsurancetoolbook.com).

LIFE INSURANCE AMOUNT WORKSHEET

Income Replacement

1. **Annual income needed.** How much annual income would your family need if you died today? Let's start with your current monthly expenses. If you don't monitor these numbers closely already, take this opportunity to get to know them.

Mortgage/Rent:	$__________
Car payment(s):	$__________
Groceries:	$__________
Clothing:	$__________
Utility bills:	$__________
Transportation:	$__________
Child care:	$__________
Medical/Dental expenses:	$__________
Travel/Entertainment:	$__________
Everything else:	$__________
TOTAL: $ × 12 months =	$__________

2. **Income that would continue after your death.** Include all salaries, dividends, interest, current (or estimated) Social Security benefits, and all other sources of income: $__________

3. **Subtract line 2 from the total in line 1.** This is the minimum amount your life insurance needs to cover for one year if you passed away today: $__________

4. **Multiply line 3 by the appropriate factor below.*** For now, let's assume that you're insuring your income for a set amount of time. That time period may be based on your life expectancy or on the amount of time that your dependents will actually be dependent (for example, through college). Let's say you were insuring $65,000 for 10 years because in 8 years, all of your kids will be out of college. You'd multiply $65,000 times 8.1 and get $526,500. Why 8.1? It's a safe assumption that your family will need only 60 percent to 80 percent of your income for basic living expenses, and that that need will lessen over time. What, then, are the funds needed to provide income for your required number of years? $ __________

*10 years: × 8.1; 15 years: × 11.1; 20 years: × 13.6; 25 years: × 15.6; 30 years: × 17.3; 35 years: × 18.7; 40 years: × 20.0

Expenses

5. **Funeral expenses.** The average cost of an adult funeral is about $10,000. Use this figure or do research to determine a more accurate number based on your preferences and region: $______________

6. **Administrative expenses.** (Also referred to as an emergency fund or final expenses.) These types of expenses can vary when cleaning up the affairs of the deceased (adviser fees, lawyer fees, and filing taxes, for example). But this number should be approximately 6 months of your annual salary (50 percent of annual income): $______________

7. **Mortgage and other outstanding debts.** Include here any outstanding mortgage principal, credit card debt, car loans, home equity loans, student loans, etc. $______________

8. **Education costs.** If you plan to cover the costs of your child's/children's (or another dependent's) college or private education, consider those costs here. Multiply the average cost you researched and any current or future costs for private education by the number of children. $______________

9. **Multiply line 8 by the appropriate years before college age.*** Like line 4 above, the factors account for a decreasing need. For example, if you planned on sending two children, one age 8 and the other age 13, to public college, you'd multiply $60,852 (the average cost at the time of writing) by 0.82 and $60,852 by 0.68, and then add the results: $49,899 + $ 41,379 = $91,278. $______________

   *5 years: × 0.82; 10 years: × 0.68; 15 years: × 0.56; 20 years: × 0.46

10. **TOTAL. Add lines 4 through 9:** $______________

Assets

Now for your assets. Keep in mind that the value of your current assets may be considerably different from their value at the time of your death. The respective values of such assets as real estate, a family business, or other big investments may be significantly discounted due to quick, forced sale or liquidation.

10. **Bank accounts, money market accounts, CDs, stocks, bonds, mutual funds, real estate:** $______________

12. **Retirement savings IRAs, 401(k)s, Keoghs, pension and profit-sharing plans:** $______________

13. **Present amount of life insurance.** Include existing policies and group life insurance through your employer that you believe will continue: $______________

14. **TOTAL income-producing assets.** Add lines 11, 12, and 13: $______________

Total life Insurance Needed

15. **Subtract line 14 from line 10:** $______________

GROUP INSURANCE WITH AN EMPLOYER

If you've ever worked for someone else, you've probably been offered **term life** insurance at either a flat amount of coverage or a multiple of your salary as part of your benefits package. And you might have been offered the opportunity to purchase additional coverage for yourself and for your loved ones and dependents.

Here are some issues to consider when you're offered life insurance from an employer:

- In **group life** term insurance—so called because the particulars of your policy depend upon the company's pool of policyholders—premiums typically increase either annually or every fifth year (age 30, 35, etc.).
- Coverage is usually not portable. In other words, if you leave the employer, your coverage is discontinued.

If you are in good health, purchasing additional life insurance coverage through your employer (beyond what your employer may offer and pay for) is almost always more expensive over any long period than purchasing an individual policy on your own. Why? Because the underwriting—the process of determining the rate you pay based on the level of risk you pose—is not selective with group-based policies; the group has to cover all employees to a certain extent. While individualized underwriting is generally required if you decide to purchase more than a basic amount of coverage through the group plan, the rates you pay still have to account for the generalized risk the insurance company is taking on by covering the group.

Notes

Capital Preservation Method

An alternative or supplementary method for determining an appropriate amount of life insurance is the capital preservation method. This method is particularly useful if you are concerned about providing annual income for dependents for some unspecified period of time after your death. With this approach, you assume that the death benefit (the principal) is left intact and invested (either by the insurance company or by a financial manager) and the beneficiaries live off the income the principal produces. You can use this method in tandem with the Life Insurance Amount Worksheet provided earlier in this chapter.

1. Use the annual income you calculated in exercise 2. Add any annual expenses (not total expenses) for items such as education costs.
2. Next, divide this figure by the assumed after-tax rate of return (a conservative estimate is best) that could be earned on the invested principal.

Annual income (replacement) ÷ After-tax rate of return = Insurance benefit

For example, for an annual income need of $100,000 (after taxes) and an assumed after-tax rate of return on the principal (death benefit) of 5 percent per year, the replacement need would be $2,000,000 ($100,000 divided by .05).

$100,000 ÷ .05 (5 percent) = $2,000,000

On the flip side, however, if the rate of return is lower than the rate assumed, your beneficiary could run out of money prematurely. The interest rate you choose for your calculation is up to you, but a conservative and realistic interest rate will have a greater chance of ensuring security for your dependents. A good guide might be the historical rate of return on U.S. Treasury Bills.

Fill in the appropriate numbers for your situation below to determine your appropriate benefit (principal) using the capital preservation method.

________________________ ÷ ____________________ = ______________

Annual income (replacement) ÷ After-tax rate of return = Insurance benefit

You now have a solid understanding of your motivations and reasons for purchasing life insurance and a reasonable calculation of how much life insurance you'll need. It's time to determine what kind of insurance is best for your needs.

STEP 2

Finding the Life Insurance That Is Best for You

Take a breath. Thinking about death is serious, exhausting business. And subjecting your financial situation to an X-ray isn't always fun. But you did it—and for good measure. When it comes to life insurance, your needs come first.

Now the bad news: More than 1,500 life insurance companies are active in the business, and each usually offers several different types of insurance products. That means there's a bewildering array of options at your fingertips. It can be overwhelming.

But here's the good news: Despite the seeming complexity, there are major similarities between certain types of life insurance contracts: Term insurance typically works the same from company to company, and so do different types of permanent or cash value policies. However, the devil is in the fine print/details. And here's the bottom line: All life insurance policies promise to pay an agreed-upon sum of money should you die while your policy is in-force (that is, while you're paying your premiums on time and while you're still operating within the terms of your contract). That's essentially what life insurance is all about.

Here's the biggest difference between the two major families of life insurance: One family provides coverage only for a specified amount of time. This is known as **term life coverage**. The other provides **permanent coverage** until you die (this can now go up to age 120+ on newer policies; older policies may or may not have extended maturity dates/maximum ages) and often accumulates a cash value over time.

Term life coverage means that the face value of your policy will be paid to your beneficiary if you die within the term period and not afterward—unless the term policy is renewed upon its expiration, which almost always means higher premiums. These policies do not build cash value. Most term policies include an option to exchange or convert the policy to a permanent policy without evidence of insurability.

Permanent coverage essentially means that whether you die five years from now or fifty, the **net death benefit** of your policy will be paid to your beneficiary. Permanent coverage has the potential to build **cash value**, which means that, generally, the premiums you pay (1) grow with interest; (2) can, in some cases, be borrowed against; and (3) on indexed and variable policies, can be placed within investment accounts.

As you'd expect, each of these families of life insurance has a wide set of variations and options. So the first question becomes: Which family is right for you? That's what we're here to find out.

1 REVIEWING YOUR NEEDS

Since the decision between term and permanent life insurance relies primarily on your own needs and circumstances, revisit those needs now. Looking back at exercise 1 in step 1 (page 8), answer this question: Were the majority of your checkmarks (your motivations for purchasing life insurance) next to numbers 1 through 5 or next to numbers 6 through 11?

- ◯ **Motivations fell within numbers 1 through 5:** It is likely that term life is the better fit for you. In fact, term life is the best fit for the vast majority of people.
- ◯ **Motivations fell within numbers 6 through 11:** It is possible that a permanent policy may be the right fit for you. However, you'll need to do some deeper exploration into your preferences and needs to be sure.

2 EXAMINING YOUR PREFERENCES, CONCERNS, AND LONG-TERM FINANCIAL HEALTH

Now, before we begin matching your needs to different life insurance options, let's take a look at your general preferences. Answer the following to the best of your ability:

◯ Agree	◯ Disagree	I am actively saving or accumulating assets to cover the costs of college, retirement, emergencies (a rainy day fund of six to nine months of income), and other long-term financial needs.
◯ Agree	◯ Disagree	My debts are under control and I expect them to remain so or to continue to lessen over time.
◯ Agree	◯ Disagree	I view life insurance as a form of emergency planning, and I expect that one day I will no longer need it.
◯ Agree	◯ Disagree	I am concerned about the cost of life insurance coverage in the short term.

If you agreed with the majority of these statements, term life insurance is the appropriate path for you. The fact is that most people have a finite, short(ish)-term need for life insurance, and they are interested in getting the maximum life insurance possible for the lowest cost possible (term life is substantially less expensive than permanent life when you are younger). They need to provide an emergency fund for young dependents in the case of their untimely death. And over time, their financial obligations (debts) lessen and their assets, such as retirement and college savings, increase. As this happens, their need for life insurance decreases (their dependents would have access to those assets in the case of their death).

However, if you disagreed with the majority of these statements, some form of permanent life insurance may be appropriate for you. If you believe it is important that you have coverage for the full span of your life and that you will always have a need for the security of life insurance for your family, regardless of the age of your dependents or how your other assets may grow, you should carefully investigate your permanent life insurance options.

Everything else being equal, the *main reasons to purchase permanent insurance* are: (1) if you have a dependent, such as a special-needs child or handicapped loved one, who relies almost solely on your income to live and who will need to rely on it after your death in perpetuity, or (2) if you have few, if any, other assets and don't actively plan on having any that could be used to cover the cost of your funeral, to pay off any outstanding debts, or to provide some inheritance to your family.

But I think it's safe to assume that you're the type of person who takes an active interest in financial planning. Otherwise you wouldn't have purchased this workbook, right? And for that type of person, term insurance—and paying cheaper premiums while investing the difference elsewhere—will most likely fulfill all your needs. If you would like to consider your options further, I urge you to consult Question 6 in *Questions and Answers on Life Insurance*.

To review the overarching pros and cons of purchasing term or permanent insurance, I've created the tables that follow. (But remember to look at each type of policy to understand its unique advantages and disadvantages.) This graphic comparison is pretty simple to understand; a qualified insurance agent (more on those in step 5) can help you make more sense of the details.

TERM LIFE INSURANCE PROS AND CONS

Pros	Cons
Premiums are lower than for permanent insurance. If you're young, that means you can buy more coverage when the need for protection is usually greatest.	The older you get, the higher your premiums go. This is also true of level term coverage: At renewal time, the premium goes up and remains level for the next term.
It insures specific needs that will disappear over time, such as mortgages or loans.	Coverage ceases when the term ends. Even when the policy may be renewed for another term, the ever-increasing premium may make coverage prohibitively expensive. Be sure to check the premium schedule at the specified renewal ages, and find out for how long the policy can be renewed.

TERM LIFE INSURANCE PROS AND CONS	
Pros	**Cons**
Many term insurance policies can be exchanged for or converted to a permanent policy during the term period. This conversion privilege could prove to be very important, especially if your health deteriorates and you are unable to qualify for a new permanent policy. Be sure to check the conversion eligibility period as you review the coverage before applying for a policy.	

PERMANENT LIFE INSURANCE PROS AND CONS	
Pros	**Cons**
As long as the necessary premiums are paid, protection can be guaranteed for life.	Higher premium payments compared to term life insurance, may make it hard to buy enough protection.
Premium payments can be fixed or flexible to meet personal financial needs.	It may be more costly than term insurance if you don't keep it long enough. Premiums are higher than term in the early years of the contract. Policies typically have a high surrender charge in the first few years.
The policy can accumulate a cash value that can typically be borrowed against.	Policy loans must be paid back with interest or else the beneficiary will receive a reduced death benefit. In rough times especially, policy loans can initiate a race to keep enough cash in the bucket and endanger the policy of lapsing.

PERMANENT LIFE INSURANCE PROS AND CONS	
Pros	**Cons**
The policy's cash value may be surrendered partially or wholly for the cash value, or it may be converted to an annuity. (An annuity is an insurance product that provides an income for a person's lifetime or for a specific period of time.)	The cash value accumulates on a tax-deferred basis in most cases, but this is based on current tax law, which could change over time.
A "rider" (additional feature) can be added to a policy, giving you the option to purchase additional insurance without taking a medical exam or having to furnish evidence of insurability.	
It pre-funds rising high insurance costs.	

If you've determined by now that you want term insurance, continue to the next section ("Choosing a term life insurance policy"), where I will break down the options for term policies. If you want permanent coverage, however, skip to section 4 ("Choosing a permanent life insurance policy").

3 CHOOSING A TERM LIFE INSURANCE POLICY

Term life insurance policies, generically speaking, are based on specific needs within specific time frames. So, generally, unlike permanent policies—whose forms vary according to a number of factors irrespective of needs or time frames—the form a term policy takes is fairly straightforward.

That's not to say that term policies aren't otherwise customizable; they are, and we'll examine a few of those differences. It's only to say that there's a more obvious connection between a need and a term policy. To ensure that your untimely death won't burden your loved ones with funeral costs, for example, term insurance would cover exactly that, over a contractually agreed-upon period of time (which is usually renewable at the end of the term). Or to ensure that your family won't suffer from the sudden end of an income they rely on, term insurance would cover that for a set amount of time, renewable at the end of the term. You get the idea.

Review the following information on different versions of term insurance polices with your motivations and needs in mind. Check which one best matches your needs.

Annual Renewable Term (ART)

Also known as a **Yearly Renewable Term** (YRT), this type of term policy features an annually increasing premium and a level death benefit.

Level Premium Term

Level Premium Term policies feature a level premium for a specified number of years (the premium may or may not be guaranteed for the entire level premium period). At the end of this level premium period, either the policy will terminate or the premium will commence to increase annually at a significant rate (usually prohibitively high). Some policies allow you to renew coverage for another term at very favorable rates, provided that you meet the company's **underwriting** criteria—that is, provided your health remains good. (More on underwriting in step 3.) This type of renewed coverage is known as **re-entry term**. If you don't meet the company's current underwriting standards and thereby do not qualify for the re-entry term rate, you can still keep the coverage **inforce** for a specified period of years by paying a higher rate set forth in the policy. Currently, this is the most popular type of term insurance and usually the most suitable, as it pegs your need to the specific time period.

Decreasing Term

Sometimes known as **mortgage insurance** because it's often used for mortgage cancellation in the event of your premature death, decreasing term insurance features a level premium and a decreasing death benefit. Decreasing terms can also apply to other kinds of debts as well. Since coverage decreases gradually over the years, the premium will be considerably lower than for Level Premium Term.

Return of Premium Term

Return of Premium Term allows you to receive the sum of premiums paid (sometimes with interest) after a certain number of years, usually the end of the level premium period.

TERM LADDERING

Term Laddering is a personal strategy modeled on bond laddering. You purchase multiple term policies with different guarantee periods to meet different needs. For instance, if you have a specific ten-year need (covering college costs, for example), you would purchase a ten-year guaranteed level premium policy. If you also had a twenty-year need (income for your spouse, for example) you would also purchase a twenty-year guaranteed level premium term policy. If you have multiple life insurance needs that span different time frames, Term Laddering may help you get all of the coverage you need and control costs.

If you're 100 percent certain that term life insurance is the right path for you and you've identified the type of term policy that you think best fits your needs, you can skip to step 3, as the remaining material here in step 2 deals with permanent (cash value) insurance. If you would like more information on each of the options and on selecting term life insurance, please review Questions 7 and 8 in *Questions and Answers on Life Insurance*. Keep in mind that term life insurance is the best solution for most people. (But you can always read on, of course, if you're curious.)

4 CHOOSING A PERMANENT LIFE INSURANCE POLICY

Think of a permanent/cash value policy as a bucket into which you pour liquid money. The bucket has a spigot at the bottom, and the company turns the spigot to drip money out of the bucket to pay for the expenses associated with the policy, such as cost of insurance (COI)/mortality expenses and other expenses (including overhead and other policy-specific fees). Meanwhile, money left in the bucket earns interest at a rate declared by the company. It's your responsibility to keep enough money in the bucket (by making adequate, timely premium payments) to pay the policy expenses as they come due. Even though you must put enough money into the bucket to keep the policy **in-force** (otherwise it will lapse), there is complete discretion as to when premium payments will be made—annually, semiannually, quarterly, or monthly—and in what amounts—depending on how often payments are made and whether you have the option (as with some policies) to choose your payment amount based on a range provided by the insurance company.

There are a few different categories of permanent life insurance, and each category may present multiple options. It would be impossible to cover all of those here, so please review the content on permanent policies in *Questions and Answers on Life Insurance* if you are considering this path. Here I will outline the basic information for the most common forms of permanent life insurance and help you determine which category of permanent life insurance may be best for you.

Review the following information, check those types of insurance that are most interesting to you, and then perform the self-assessment at the end of step 2 to determine which types of policies will really meet your needs and preferences.

Whole Life

With whole life, the insurance company promises to pay a certain death benefit upon your death, regardless of when that occurs, up to a certain agreed-upon age based on mortality and expense projections, along with dividend scale assumptions. All three components are projected and integral to a whole life policy. The company often pays you the full face value of the policy if you live to the end of the specified mortality table, which, as its name suggests, tabulates your life expectancy based upon your age and health. But this isn't always the case and is not always spelled out in the contract. With most forms of whole life, premium payments are made for life at a fixed rate, and the policy cannot be canceled as long as you pay the premiums on time. The cash value normally increases at a consistent rate so that it equals the face value at the age at which the policy expires. Loans against this cash value are often available. Whole life is less flexible than the other forms of permanent life insurance, and the premiums are often higher than some other forms, such as Universal Life.

In *Questions and Answers on Life Insurance*, I go into great detail about the many and varied forms of whole life insurance options, including Endowment, Limited Payment Whole Life, and Indeterminate Premium Whole Life. However, in the interest of keeping the process in this workbook manageable and succinct, I explore in the following pages just two types of whole life, which are appropriate for most people: Current Assumption Whole Life and Participating Whole Life.

THE DANGERS OF POLICY LOANS

Policy loans can be a useful short-term option when immediate cash is needed, but they are not the long-term solution so widely proclaimed. In fact, policy loans (available with most, but not all, forms of permanent life insurance) are one of the most complex, misunderstood, and misused components of a life insurance policy. Out-of-control policy loans can erode a life insurance policy over time, eventually draining the death benefit—and saddling you with a substantial tax bill.

Here's a frightening example. As part of a divorce settlement, a woman owned a whole life insurance policy that had been issued to her ex-husband in 1967, who was 38 at the time of issue. The death benefit was $100,000, to be paid upon death or at age 90.

But before the policy was transferred to the woman, a policy loan had been taken out on it. In 1999, the policy had an outstanding loan of $62,098, with an interest rate of 5 percent, which the woman had to pay regularly. The policy's basis (all premiums paid to the insurance company minus all dividends received from the insurance company or credited against the premiums) at the time was $59,018, and the net surrender value—the amount she'd get if she gave up the policy—was $947. The policy had reached a point at which it was "overloaned," which meant that no further loans were available because the maximum available loan limit had been reached. (The maximum available loan limit is a percentage of the cash value; in other words, you can't borrow a greater amount than your gross cash value.)

The woman received a bill of $2,950 for loan interest due, and the annual premium due was $2,152. This meant that there was an annual cost of $5,102 to carry a policy with a net death benefit of $37,902 (death benefit of $100,000 minus the outstanding loan balance of $62,098).

The policy owner could pay the $5,102 to keep the policy in-force. Or she could surrender the policy and collect the $947, but that would have resulted in taxable "income" of $4,027, calculated by taking the net surrender value of $947 plus the outstanding loan of $62,098 and subtracting the basis of $59,018. In this scenario, she would have had to pay about $1,611 in income taxes, and she no longer would have the benefit of the life insurance policy.

Borrowing from a policy can be helpful when times are tough, but loans must be used responsibly. The policy can relapse if the loan is not repaid, and the loans can be complex and destructive if not handled with care.

Current Assumption Whole Life

Current Assumption Whole Life policies make use of a current dividend scale in setting the cash value, along with an indeterminate premium structure. The dividend scale is not fixed—it does change—and is usually declared on an annual basis by the insurance company. The gross premiums are fixed, while the net premiums can sometimes be reduced/offset by dividends.

Participating Whole Life

All whole life policies are either participating or non-participating. A participating policy charges a higher premium and in return pays you regular dividends. Dividends are not guaranteed and depend on the company's actual investment return experience with all of its **in-force** policies. Dividend options include:

- Cash
- Purchase of fully paid-up life insurance in small increments with each dividend
- Reduction of the next premium payment
- Retention by the company at interest
- Purchase of one-year term insurance in an amount equal to the cash value at the time of purchase

A trade-off for dividends is with higher, lower, or no further premiums. The policyholder under some policies can have the option at some point to switch his or her dividend option to reduce or pay premiums in full. The higher premiums are for particular policies (not always an option) where they are called "limited payment," though not guaranteed limited payment.

Universal Life

Universal Life (also known as Flexible Premium/Adjustable Life)

The biggest difference between Universal Life (UL) and whole life is that UL gives you considerable flexibility as to the amount and timing of premium payments. Furthermore, the face amount of coverage can be changed (down at any time, up with evidence of continued insurability).

UL is unique in the sense that this type of policy "unbundles" the pricing elements that make up a traditional cash-value permanent policy—interest earnings, mortality costs, and company expenses—and prices them separately. Ideally, this gives you better transparency into the moving parts of your policy. In practice, however, this can get a little complicated. With a traditional whole life policy, you have but one responsibility: to pay the premiums when due. If premiums are paid when they come due, the policy will never lapse, and eventually it will mature as a death claim, period.

UL is different. If the policy owner fails to fund it adequately, UL may turn out to be temporary rather than permanent life insurance. The company may change pricing elements subject to certain limits set forth in the policy. So the company may raise the expense charges and mortality costs and lower the amount of interest credited to the accumulating funds. If these policies are handled incorrectly, they can turn out to be more expensive as you grow older, the cash value can erode, and the policy could end up lapsing if premium payments aren't high enough to continue to fund the policy (remember the bucket analogy from the beginning of this section). Most UL policies sold prior to the mid-1990s were based on the assumption that the higher interest rates of that era would continue indefinitely. Falling interest rates mean that many of those policies are destined to lapse long before the policy pays off as a death claim due to inadequate premium funding. Furthermore, some UL companies have subsequently increased their mortality and expense charges to levels higher than those illustrated when the policies were originally issued.

Therefore, it's essential with UL policies that you order an **in-force illustration** at least every two or three years, as it's the only effective way to monitor the progress of a UL policy. (Sample request letters for this purpose are provided in step 7.) An in-force illustration is a report of current values and assumptions compared with guaranteed minimum values.

Guaranteed Universal Life

Guaranteed Universal Life policies comprise one of the fastest growing segments of the life insurance industry. These policies guarantee the death benefit as long as all scheduled premiums are paid in full when due. These policies may or may not accumulate a cash value—they are designed to provide coverage past age 95/100 and up to age 120. Most insurance policies will terminate (mature) at age 95 or 100 and cash out at that time, leaving the insured to self-insure. In essence, they function as a lifelong term life insurance policy, where you have the option to accumulate a cash value. A note of caution: if you miss a scheduled premium or pay less than the total premium due, you may lose the guaranteed death benefit.

Equity-Indexed Universal Life

Equity-Indexed Universal Life (EIUL) is a newer form of UL insurance that is extremely complex and combines elements of variable life (which you'll read about next) into the mix. The main difference between this and traditional UL is in how excess interest is credited. Most EIUL policies have two separate accounts that can be used to credit interest. One account has a fixed interest rate that is declared by the insurance company periodically. The second account provides an equity index option that offers you the opportunity to earn rates of interest based on positive equity (stock) market returns. However, the cash value of the EIUL policy is not exposed to losses due to negative market returns.

The amount of interest credited to your cash value is tied to the performance of the policy's particular equity index. Companies use a range of indexes that include the S&P 500, Dow Jones Industrial Average, Lehman Brothers Bond Index, and FINRAAQ. In years where the index performs well, the interest credited to the policy's cash value rises, and in years where the index performs poorly, the interest rate falls. Typically, EIUL policies guarantee that the interest rate will never fall below zero so that the policy won't lose money if the stock market index declines.

The first thing to watch out for is that these policies usually have a cap or limit on the amount of interest that can be credited to your policy. Therefore, if the cap is 10 percent, and the index return is 14 percent, you will only earn 10 percent. The reasoning is that this would offset the liability the life insurance company assumes in years where there is a negative return in the stock market index.

The insurance companies can, at their discretion, also adjust what is called the participation rate, so that a policy owner receives a lesser percentage of the total return. This is an important thing to look for. Some companies will offer a 100 percent participation rate guaranteed for the life of the policy. But if a policy has an 80 percent participation rate, and the policy has a cap of 10 percent, the most you will ever earn on the policy is 8 percent (80 percent of 10 percent).

There are also different indexing methods that are used in measuring the market return, which you should understand before signing a policy. You can learn more about those methods on my website, www.lifeinsurancetoolbook.com.

Variable Life and Variable Universal Life

As with Universal Life polices, Variable Life and Variable Universal Life policies provide death benefits and cash values to beneficiaries. But here's the crucial difference: whereas the premiums paid into most standard UL polices earn interest within a life insurance company's General Account, as it's known, Variable Life policies earn interest on a portfolio of investments that you, as the policy owner, choose from a selection offered by the company (key: check the selections). In addition, a Variable Life or Variable UL policy may be surrendered for its cash value at any time, and the policy owner also has the option of exchanging the policy for an annuity contract.

Depending on how financially savvy you are, selecting your own portfolio can be an acceptable aspect of this type of policy or a very dangerous one. When an insurance company invests your premium into its General Account, it bears the risks inherent to investing and credits your policy with interest based on the account's performance. There's no direct link between the company's investment portfolio and the declared interest rate on your policy. But with Variable Life policies, there's a direct link between the cash value of your policy and the performance of the portfolio of sub-accounts you choose. You bear the risk. The cash value and death benefit of your policy is not guaranteed. (But some policies do guarantee that the death benefit cannot fall below a minimum level.) So if your portfolio does well, the earnings on the cash value of your policy may exceed what you would have earned through a standard UL. But if the performance of your portfolio tanks, you'll have to put in additional funds to keep your policy in force. That can get pricey and could endanger your policy.

JOINT-SURVIVOR (SECOND TO DIE) LIFE INSURANCE

Joint-Survivor Life is a type of coverage that can be a part of any type of permanent cash-value policy. This type of coverage insures two people (usually spouses) and pays a benefit only at the second death. It's used primarily for estate planning purposes, as the estate tax is usually only payable at the second death.

While you may see tax advantages with this type of policy—you are earning returns or income that you do not have to pay taxes on—there are fees associated with the policies that may offset the tax advantages. Federal and state premium taxes average around 3 percent of premiums. Mortality and expense charges assessed against cash values can range from .6 to .9 percent. Asset management charges can vary from .2 to 1.6 percent. And surrender charges can typically exceed the first year's premium and last 10 to 15 years.

Overall, the costs of Variable Life policies can be higher than other types of permanent policies.

You'll get a legally entitled prospectus from an insurance company before you purchase either a Variable Life or Variable UL policy. And you'll definitely want to read it, even though it's lengthy and tedious to pore through. If you have a tough time understanding it, find someone who does who can explain it to you. (But if you have to do that, ask yourself: Is this the right kind of policy for me?) Many factors affect the performance and well-being of a Variable Life or Variable UL policy. For advice on the investment accounts, always consult a properly licensed financial/investment adviser.

Self-evaluation for Permanent Life Insurance

Now that you've looked at the most common types of permanent insurance, take a moment to review what you've learned. If you centered on a particular type of permanent policy, why do you think that policy fits your needs? If you originally thought you wanted a particular type of policy but now you're not so sure, why do you think that is?

Often, the right choice depends on your financial savvy and your risk tolerance. Look at the following two scales and place the number that corresponds to how you rate yourself in the checkbox to the left of each question.

How would you rate your financial savvy?

Very Low	Low	Medium	High	Very High
I don't understand.	I know what stocks and bonds are, but am not really familiar with the mechanics of financial markets.	I've dabbled into financial investments, but still have a lot to learn.	I'm no pro, but am conscientious enough to make informed decisions about long-term investments.	I'm intimately aware of the risks inherent in investing, and am experienced with stocks, bonds, and other financial vehicles.

How would you rate your risk tolerance?

Very Low	Low	Medium	High	Very High
Risk tends to frighten me.	Not a fan of it, but can be convinced if I'm nearly positive of an acceptable outcome.	I generally like risk, but am more of a "bear"-like investor. I could describe my investment habits as slow, sound, and steady.	I've got low-risk accounts in my portfolio, but I like to pursue hot new stocks that have a chance of paying out big.	I like to gamble, so to speak. The bigger the potential reward, the more likely I am to go for it.

The implications of your answers here are becoming a little clearer, right? Select the profile that matches your previous selections to learn more about the policies that may be right for you.

- **High Financial Savvy/High Risk.** If you've got a relatively high risk tolerance and are financially savvy, a **whole life** policy probably doesn't make much sense. Such policies are steady, secure, safe, and predictable. A **Universal Life,** including **Equity-Indexed Life** and **Variable Life**, policy most likely resonates a bit more with you. The questions for you are: Are there alternative financial vehicles that are better fits for my financial-savvy and risk-tolerance profiles? Is life insurance the right place for me to play with this much risk, devote this much time to financial monitoring, and take on these expenses?

- **Low Financial Savvy/Low Risk.** If you have a relatively low risk tolerance and aren't financially savvy (that is, you placed low on both scales), **Universal Life**, including **Equity-Indexed Life** and **Variable Life**, policies aren't good fits for you. They're more complex, have more moving parts, and are much more risky. A **whole life** policy is probably a better choice. The question for you then becomes: How clear am I on my needs for life insurance? The clearer and more specific your needs are (in terms of a finite period of years), the more likely a **term** policy might work just as well for you (skip back to the term life discussion to learn more).

- **Low Financial Savvy/High Risk.** If you have a relatively high risk tolerance but aren't very financially savvy, **Universal Life,** including **Equity-Indexed Life** and **Variable Life**, policies can be very dangerous. That's the life insurance equivalent of playing chicken on a narrow bridge. The question for you becomes: Am I feeling lucky? Because you're going to need a lot of luck in order for that to work for you. If you're set on choosing a permanent policy but fit this profile, (1) stick to a safer option like a **whole life** policy and, (2) for your own sake, make it a goal to learn more about basic finances. That way you've got a reasonably safe life insurance policy, while, in the meantime, you work to match your financial wits with your risk tolerance.

- **High Financial Savvy/Low Risk**. If you have a relatively low risk tolerance but have a higher degree of financial savvy, you're probably already comfortable knowing that **Universal Life,** including **Equity-Indexed Life** and **Variable Life**, polices aren't the right fits for you, even if you're confident you could understand their mechanics. **Whole life** policies are the most financially conservative of the bunch, which you've probably recognized. The question for you becomes: Are there similarly less-risky term policies that fit with my needs, and how clear am I on those needs?

By now, you've reviewed the different types of insurance and found the best fit for your situation. Sometimes this might include two or three different policies to meet specific needs and goals (the term laddering concept) or combining a term policy and a permanent policy. More detailed information on the different types of policies can be found in *Questions and Answer on Life Insurance*.

Your next step is to discover the personal health factors (including your financial soundness) that may affect the nature or cost of your life insurance policy.

STEP 3

Identifying the Health Factors That Can Affect Rates

Whether you've chosen the term route or the permanent route, one thing's for sure: your health and your medical history—even the physical shape you're in once you apply for a policy—are going to play a major part in determining how much you pay for life insurance. And in some cases, your financial situation may also come into play.

Think of it like a credit rating. In finance, the better your credit score, the more favorable your interest rate. The worse your credit score, the more you'll pony up. In life insurance, good "credit scores" are known as **preferred** or **standard** rates. Good health, good medical history, and good physical fitness earn you good credit scores and thus better rates. This is what a life insurance company likes to see. A lower credit score (that is, poorer health and fitness) results in a **rated** premium, which factors in the higher level of risk an insurance company believes it's taking on to insure you. The adjusted rates can be significant if you have a major condition like cancer or heart disease; the adjusted rates can be relatively minor if your height-to-weight ratio isn't optimal or if you have high blood pressure.

These rates are determined during the life insurance company's **underwriting** process, which, to stick with our credit-score metaphor, is like a "credit check" on your health. Different life insurance companies have different underwriting standards; because the standards will determine the rates you pay, you'll want to be well aware of the differences among them before you sign on the dotted line.

More details on the underwriting process are to come. For now, take a few moments to take a good look at your financial health and well-being.

YOUR FINANCIAL HEALTH

If you are considering large amounts of coverage or if the insurance you are requesting is tied to a business, insurance companies will likely ask you questions about your financial life. This is called financial underwriting. What the company will be looking for is an insurable interest, meaning that there is a specific need or financial logic for the coverage. If someone who makes $45,000 a year requested coverage of $10 million, the insurance company would question the insurable interest. Why would that person need that much life insurance, and would he or she have the financial wherewithal to continue to pay the premiums over time? Insurance companies are specifically looking for fraud.

You, as an individual applicant, may have to justify to the insurance company the amount of coverage applied for. Life insurance companies are sensitive to the over-insurance problem—where someone is insured for more than an insurable interest. When someone applies for a large amount of life insurance, there is a reason why. Financial underwriting seeks to find out why, and to ensure that the amount of coverage can be justified. Therefore, the amount of coverage bears a definite relationship to the applicant's net worth and income. The underwriter needs to know the purpose of the coverage applied for. This helps the underwriter determine if the beneficiary's economic loss—in the event of the insured person's death—is in line with the total amount of insurance **in-force**.

1 EVALUATE YOUR HEALTH

Your results from the following quiz won't give you any guarantee of your success during a life insurance company's underwriting process, but they will give you a general idea of what you can expect. An experienced insurance adviser can help you sort through the process and get you the best offer from a suitable company.

Each scale shows ratings from 1 to 3. Put a checkmark next to the score that best fits you.

Tobacco Usage (Nicotine)

☐ **1**	☐ **2**	☐ **3**
No use of tobacco or tobacco substitutes in the last 5 years (occasional cigar use may be okay if minimal and current nicotine test is negative)	No use of tobacco or tobacco substitutes in the last 3 years (occasional cigar use may be okay if minimal and current nicotine test is negative)	No use of tobacco or tobacco substitutes in the last 2 years (occasional cigar use may be okay if minimal and current nicotine test is negative)

Family Health History

1

No cardiovascular or cancer disease (except basal cell carcinoma) in either parent or siblings at or before age 60

2

No cardiovascular or cancer death in either parent at or before age 60

3

No more than one cardiovascular death at or before age 60

Driving History

1

No DWI, DUI, reckless driving, license revocation, or suspension in the last 5 years

2

No DWI, DUI, reckless driving, license revocation, or suspension in the last 3 years

Blood Pressure

1

No current, or history of, blood pressure treatment or medication. Readings have never exceeded:

* 140/85 (age 60 or younger)
* 150/90 (age 61 or older)

2

Currently controlled. Average reading in the last 2 years (including treatment) does not exceed:

* 140/90 (age 60 or younger)
* 150/90 (age 61 or older)

3

Currently controlled. Average reading in the last 2 years (including treatment) does not exceed:

* 150/90 (age 60 or younger)
* 155/90 (age 61 or older)

Cholesterol

☐ **1** 240 mg/dl (treated or untreated —maximum reading)	☐ **2** 270 mg/dl (treated or untreated —maximum reading)	☐ **3** 285 mg/dl (treated or untreated —maximum reading)

Cholesterol/HDL Ratio

☐ **1** 5.0 (maximum)	☐ **2** 6.0 (maximum))	☐ **3** 7.0 (maximum)

Alcohol/Substance Abuse

☐ **1** No history or treatment for alcohol or substance abuse: ever	☐ **2** No history or treatment for alcohol or substance abuse: last 10 years	☐ **3** No history or treatment for alcohol or substance abuse: last 7 years

Your Score and What It Means

Tally the numbers you circled for the seven health-related scales and check the box next to the appropriate range below.

- ◯ **7–11.** Based on general underwriting measurements of health, it looks like you're in a **Tier 1** category of health. That's the best tier available. You very well might qualify for a life insurance company's **preferred** rate. Remember, however, that different companies have different parameters (and tiers). In the most conservative companies, for example, even an infrequent use of nicotine could adjust your rate.

- ◯ **12–16.** Based on general underwriting measurements of health, it looks like you're in a **Tier 2** category of health. This is neither here nor there. You're most likely not in the best medical condition to qualify for **preferred** rates, but you probably won't be hit with the worst rates, either.

- ◯ **17–21.** Based on general underwriting measurements of health, it looks like you're in a **Tier 3** category of health. Your life insurance rates will most likely be on the higher end.

Also note that some measurements of risk will almost always carry a flat extra premium. These include, but aren't limited to: (1) if you're an aviation pilot and (2) if you have a hazardous professional occupation or hobby. And your likelihood for the most favorable rates also depends on basic height-to-weight ratios. Take a look at the following height/weight tables from one life insurance company to get an idea of the ratios that yield the best rates:

BUILD CHART (Female):					
Height	Weight	Height	Weight	Height	Weight
5'0"	145	5'7"	176	6'2"	216
5'1"	149	5'8"	182	6'3"	222
5'2"	153	5'9"	188	6'4"	227
5'3"	158	5'10"	193	6'5"	233
5'4"	162	5'11"	199	6'6"	238
5'5"	166	6'0"	205	6'7"	243
5'6"	170	6'1"	211	6'8"	249

BUILD CHART (Male):					
Height	Weight	Height	Weight	Height	Weight
5'0"	154	5'7"	192	6'2"	234
5'1"	159	5'8"	197	6'3"	240
5'2"	164	5'9"	203	6'4"	246
5'3"	169	5'10"	209	6'5"	253
5'4"	175	5'11"	215	6'6"	260
5'5"	180	6'0"	221	6'7"	266
5'6"	186	6'1"	227	6'8"	273

2 PREPARE YOUR HEALTH INFORMATION

How are you feeling at this point in evaluating your health? Encouraged? Discouraged? Use the space below to write out your biggest concerns when it comes to your health. That way you'll be better prepared once you meet with an insurance professional. (For more details, see the "Tips for Preparing for Your Underwriting Physical" checklist in step 6.) Also, think about which aspects of your health you can control and which you can't; write out, for your own sake, which healthy habits you can begin today—and which unhealthy ones you can discard.

Notes on Health Issues

WHAT IS THE MEDICAL INFORMATION BUREAU?

If you have ever applied for life, health, or disability insurance, chances are you're in the Medical Information Bureau's (MIB's) database. MIB is a valuable asset to both the life insurance industry and the insurance-buying public because by helping to detect insurance fraud—which runs up claim costs, which then in turn affects everyone who pays life insurance premiums—it keeps premium costs low.

MIB is an information clearinghouse that stores information about processing and underwriting cases gathered from more than 600 insurers. Member companies send an inquiry to MIB and receive a short, coded report with data on the applicant's medical history and other relevant underwriting information that helps the company assess the risk of the applicant. MIB carefully guards the privacy of the information in its database, and only member companies may access it. All MIB member companies must agree to a strict set of standards for use of the data provided.

MIB is a taxpaying organization, supported by assessments from member insurance companies based on their total insurance **in-force** and business written in the previous year. It is estimated that 90+ percent of the individual life insurance policies and 80 percent of the health and disability policies issued in the United States and Canada are subject to the MIB system. This is done through member companies and reinsurance treaties that nonmember companies have with member companies.

It's not a bad idea to get a peek at the information this bureau has on you. You can get an annual record disclosure without charge. Just call MIB's toll-free number: 866-692-6901 (866-346-3642 for the hearing impaired). According to the MIB website (www.mib.com), here are a few things to keep in mind once you decide to submit a record request:

- If you have not applied for individually underwritten life, health, or disability insurance within the last seven years, MIB will not have a record on you.
- You'll need to give personal identification information to help MIB locate your record, if one exists, and it may verify the identification information you provide with other consumer reporting agencies.
- You will be asked to certify under penalty of perjury that the information you provide about yourself to request MIB disclosure is accurate and complete and that you are the person who is requesting disclosure.
- Upon receipt of your (a) request for a Record Search and Disclosure, and (b) proper identification, MIB will initiate the disclosure process and provide you with the nature and substance of information, if any, that MIB may have in its files pertaining to you; the name(s) of the MIB member companies, if any, that reported information to MIB; and the name(s) of the MIB member companies, if any, that received a copy of your MIB record during the twelve-month period preceding your request for disclosure.

You have the right to correct any inaccurate or incomplete information that may be in the record.

Try not to get too discouraged if you're not in tip-top shape. Remember, different insurance companies have different standards. Plus, I've found that in a significant percentage of the cases in which the initial offer from the insurance company isn't favorable, it's due to poor communication about your health. Maybe the Medical Information Bureau's records aren't entirely accurate. Or maybe the medical director the insurance company employs during the underwriting process discovers something your own personal physician hasn't been forthcoming to you about. Or maybe the insurance carrier just hasn't been given the full picture. That's why it's so important to take a comprehensive, proactive approach to understanding your own health and the records about it that exist. And if the insurance company comes back with a rated premium, it's critical that you find out what that rating was based on, and if the rating is justified.

Before we leave the topic of your health, there's one more important thing you should know. It probably goes without saying, but when it comes to the underwriting process, *honesty is the best policy***.** Don't fib or omit, even though you think you might be able to get a better rate if you do. And here's why (apart from the ethical considerations): It could really come back to bite you and your beneficiary.

In some cases, when your life insurance application is taken and you've tendered an initial premium payment, you'll receive a **conditional receipt**. A conditional receipt binds your life insurance coverage effective on the date of your application, provided the underwriting process determines that you're eligible for the coverage for which you applied. That means that even if you die in an accident the day after your application is submitted, your beneficiary will be awarded the death benefit for which you applied. But if the reason you suddenly die is in any way related to an undisclosed medical condition—known or unknown—that's discovered in the underwriting process, your beneficiary *will not* receive the death benefit.

And most policies are issued with an **incontestability clause**, which means that unless you don't pay your premium, the insurance company cannot contest the insurance contract during your lifetime as long as the original policy is **in-force**, no matter how your health may change. But there is almost always a window (usually for about two years) after the policy becomes **in-force** during which the insurance carrier *can* contest the contract if there's any reason to do so, such as if it comes to the carrier's attention that you haven't disclosed a health condition.

Again, honesty is the best policy. Don't risk it.

Being honest with yourself about any health issues will help you to maximize your premium dollar. If you do have issues, having an adviser who represents multiple companies is important. Make sure the adviser discusses any potential areas of concern with a company's underwriter before you fill out an application or take any tests. Don't commit until you know the company will consider you.

You are now ready to begin evaluating companies and agents and working with them to select and purchase the policy and components that are just right for you.

PART II

EVALUATE COMPANIES AND AGENTS AND PURCHASE A POLICY

STEP 4

Selecting a Life Insurance Company

Maybe you've never purchased life insurance before. (If that's the case, part I should have been particularly useful to you.) Maybe you have a term policy that's nearing its expiration and, while you'd like to renew, you're just not satisfied with the life insurance company it's with or with the life insurance adviser who steered you in that company's direction. Or maybe you're looking for a new, separate policy to cover a different need, and you're considering your options.

Whichever scenario it is, you're in the right place.

Now that you understand how much and what type of life insurance you may need, it's time to (1) find the best insurance company for you and (2) find a qualified insurance adviser.

Step 4 tackles the first of those two issues: finding the right insurance company. (Step 5 will explain how to choose the right agent or adviser.) Could you find an adviser first and *then* let him or her guide you through the dense thicket of company options? Sure you could. But you probably bought this workbook because you want to be an educated consumer and because you want to do some of the preliminary research on life insurance options. That's why I recommend this step first. If you already have a trusted adviser, you can reverse the steps, of course, choosing the right insurance company second. In addition, if you have a medical issue, you'll need an adviser to help you find a company that will offer coverage.

And besides, when you can go in prepared, speaking the same language as the adviser and the company, everyone wins.

So, where to begin? My rule of thumb is simply to identify the top-rated companies that offer the particular type of policy you desire. The key to breaking through the clutter of the vast array of options (remember,1,600 life insurance companies have products to offer you) is to hold each company to this predetermined **set of benchmarks**:

1. Does the company have one of the **top tiers**—1st, 2nd, 3rd, sometimes 4th highest—from one or more of the independent companies that rate life insurance providers?

2. Does the insurance company hold itself to any official ethical standards?

3. How many complaints—and of what nature—are filed against the company in question?

Here's the deal I'll make with you. In this step, I'll give you the tools and resources to research each of these benchmarks if you'll put in the legwork. Sound good? I'll start by providing the resources in the order of the benchmarks I've listed, and then the remainder of the step will be consisted of a set of worksheets you can use during your research on each company. You could start by visiting these resources and determining your choices from there, or you can do some of your own online research and use these resources to effectively grade the companies you've singled out as viable options. It's up to you.

1 FAMILIARIZE YOURSELF WITH THE AGENCIES THAT RATE LIFE INSURANCE COMPANIES

A **rating** is just a way for the big four rating agencies—A.M. Best, Fitch, Moody's, and Standard & Poor's—to express their independent judgments of a life insurance company's financial soundness and creditworthiness. Each agency's rating system varies in its stringency and its methodology, but all four consider a company's financial leverage, management stability, recent performance, overall financial health, and such external factors as competition, diversification, and market presence. Don't worry too much about the details here; suffice it to say that an insurance company with a top rating from at least three of the four agencies is in great standing. Each company does weigh each component differently.

You might think that large, respected life insurance companies are exempt from financial meltdown. But they're not. Take Mid-Continent Life, an Oklahoma-based life insurance company that was taken over by the state's insurance department in 1997. Lack of product diversification was a leading factor behind the company's failure. The company primarily marketed one policy type and, when that product proved to be underpriced, the entire company was at risk. Today, more than a decade later, the fate of the 130,000 policy owners is still murky at best.

That's why it's so important to consider the financial well-being of a life insurance company *before* you commit.

At the end of this step (on page 45) is a detailed worksheet that you will complete with the relative ratings for the companies you are considering. You might also refer to Question 47 in *Questions and Answers on Life Insurance* for more information on this topic.

DEEPER INSIGHT

Comparing ratings from each rating agency is a reliable way to evaluate insurance providers. For the financially savvy who can tease apart complex financial reports and want to review more advanced evaluations of a provider's financial health, such as financial analysis, Insurance Regulatory Information Reports (IRIS), and Risk Based Capital (RBC) system, see Questions 49 through 51 in *Questions and Answers on Life Insurance.*

What follows is a snapshot of each rating company's nature and a look at what their top tiers of rating categories mean. Websites change a lot, so keep looking—the information's there. Also note that you'll need to establish free accounts for some of these services.

A.M. Best Company | www.ambest.com | 908-439-2200

Profile

A.M. Best is the most experienced rating insurance company, having been in the business since 1906. Its Financial Strength Rating is recognized worldwide as the benchmark for assessing and comparing insurers' financial stability.

To enhance the usefulness of ratings, A.M. Best assigns each rated (A++ through D) insurance company a Financial Size Category (FSC). The FSC is designed to provide a convenient indicator of the size of a company in terms of its statutory surplus and related accounts. All that means is that you'll have additional peace of mind that the company you're dealing with is healthy.

What the top ratings mean

- **A++ and A+ (Superior)—**Assigned to companies that have, in A.M. Best's opinion, a superior ability to meet their ongoing obligations to policyholders.
- **A and A- (Excellent)—**Assigned to companies that have, in A.M. Best's opinion, an excellent ability to meet their ongoing obligations to policyholders.
- **B++ and B+ (Good)—**Assigned to companies that have, in A.M. Best's opinion, a good ability to meet their ongoing obligations to policyholders.

Fitch | www.fitchratings.com | 800-753-4824

Profile

National Insurer Financial Strength (IFS) ratings serve the needs of local insurance markets. As with other forms of national ratings assigned by the agency, IFS ratings also assess the ability of an insurer to meet policyholder and related obligations, relative to the "best" credit risk in the country for which the rating appears across all industries and obligation types.

On the website, you'll find a detailed business review and overall outlook for the company. In particular, you should pay attention to the following:

- The product mix (life, annuities, group insurance) (Diversity here is good.)
- The company's marketing focus (Upscale and advanced marketing is usually a sign that much of the company's business is tax-oriented.)
- The primary states where the company sells insurance (Diversification among several states is advised.)
- The company's reinsurance practices (Reinsurance is insurance purchased by the insurance companies to further manage risk.)

- The quality of the assets in which the company invests (High-risk investments—junk bonds and defaulted mortgages, for example—have caused the downfall of several large insurance companies, such as Executive Life, First Capital Life, and Monarch Life; a company's exposure to such investments should be very limited.)

What the top ratings mean

- AAA—Assigned to companies that, in Fitch's opinion, have the highest rating within the national scale for a particular country. The rating is assigned to the insurance entities' obligations to their policyholders, with the lowest credit risk relative to all other obligations or issuers in the same country, across all industries and obligation types.
- AA—Assigned to companies that, in Fitch's opinion, have a very strong capacity to meet policyholder obligations relative to all other obligations or issuers in the same country, across all industries and obligation types. The risk of ceased or interrupted payments differs only slightly from the country's highest-rated obligations or issuers.
- A—Assigned to companies that, in Fitch's opinion, have a strong capacity to meet policyholder obligations relative to all other obligations or issuers in the same country, across all industries and obligation types. However, changes in circumstances or economic conditions may affect the capacity for payment of policyholder obligations to a greater degree than for financial commitments denoted by a higher-rated category.

CONFLICT OF INTEREST?

In most cases, life insurance companies must pay a fee to be rated by one of the big four rating agencies. And sometimes these fees are pretty steep—tens of thousands of dollars even. If you're inclined to think this setup might affect the objectivity of the rating agency, don't worry: A rating agency depends upon its reputation. It wouldn't be in business without it, though after the latest financial crisis, this has been a subject of debate and there have been hints of some other type of federal rating entity.

Moody's | www.moodys.com | 212-553-0377

Profile

Moody's Insurance Financial Strength (IFS) ratings are opinions of ability of insurance companies to punctually repay senior policyholder claims and obligations. Specific obligations are considered unrated unless they are individually rated because the standing of a particular insurance obligation would depend on an assessment of its relative standing under those laws governing both the obligation and the insurance company.

What the top ratings mean

- **Aaa—**Assigned to companies that, in Moody's opinion, offer exceptional financial security. While the credit profiles of these companies are likely to change, such changes as can be visualized are most unlikely to impair their fundamentally strong position.

- **Aa—**Assigned to companies that, in Moody's opinion, offer excellent financial security. Together with the Aaa group, they constitute what are generally known as high-grade companies. They are rated lower than Aaa companies because long-term risks appear somewhat larger.

- **A—**Assigned to companies that, in Moody's opinion, offer good financial security. However, elements may be present that suggest a susceptibility to impairment sometime in the future.

Standard & Poor's (S&P) | www.standardandpoors.com | 212-438-2400

Profile

Standard & Poor's Insurer Financial Strength rating is a current opinion of the financial security characteristics of an insurance organization with respect to its ability to pay under its insurance policies and contracts in accordance with their terms. But note that this opinion is not specific to any particular policy or contract, nor does it address the suitability of a particular policy or contract for a specific purpose or purchaser. Furthermore, the opinion does not take into account deductibles, surrender or cancellation penalties, timeliness of payment, or the likelihood of the use of a defense such as fraud to deny claims.

Insurer Financial Strength Ratings are based on information furnished by rated organizations or obtained by Standard & Poor's from other sources it considers reliable. Standard & Poor's does not perform an audit in connection with any rating and may on occasion rely on unaudited financial information. Ratings may be changed, suspended, or withdrawn as a result of changes in, or unavailability of, such information or based on other circumstances.

Insurer Financial Strength Ratings are not a recommendation to purchase or discontinue any policy or contract issued by an insurer or to buy, hold, or sell any security issued by an insurer. A rating is not a guaranty of an insurer's financial strength or security.

In the report, you'll find a fairly detailed report. Pay attention in particular to the following data:

- Total assets for five years (The goal is moderate growth over this period with a recommended minimum of $2 billion in assets.)

- Total liabilities (should experience roughly the same growth rate as total assets)

- Net income (should remain relatively stable)

- Business review and history

- A pie chart indicating the company's product sales (This is particularly important in times of change. If a company sells too much of any one product type—individual annuities or permanent life insurance, for example—a sudden shock to the marketplace, such as a change in the economy or tax system, could result in a sharp decline in the company's business.)

What the top ratings mean

- **AAA**—Assigned to companies that have, in S&P's opinion, extremely strong financial security characteristics.
- **AA**—Assigned to companies that have, in S&P's opinion, very strong financial security characteristics, differing only slightly from those rated higher.
- **A**—Assigned to companies that have, in S&P's opinion, strong financial security characteristics, but are somewhat more likely to be affected by adverse business conditions than are insurers with higher ratings.

Here's a glimpse of each agency's rating system side by side. Remember, you're looking for a company with a top rating with at least three of the four agencies.

RANK	A.M. BEST	FITCH RATINGS	MOODY'S	STANDARD & POOR'S
1	A++ (Superior)	AAA	Aaa (Exceptional)	AAA (Extremely Strong)
2	A + (Superior)	AA (Very Strong)	Aa (Excellent)	AA (Very Strong)
3	A (Excellent)	A (Strong)	A (Good)	A (Strong)
4	A- (Excellent)	BBB (Adequate)	Baa (Adequate)	BBB (Good)
5	B++ (Good)	BB (Fairly Weak)	Ba (Questionable)	BB (Marginal)
6	B (Fair)	CCC	Caa (Very Poor)	B (Weak)
7	B- (Fair)	CC	Caa (Very Poor)	CCC (Very Weak)
8	B- (Fair)	CC	Ca (Extremely Poor)	CC (Extremely Weak)
9	C++ (Marginal)	C	C	R (Under Regulatory Supervision)
10	C+ (Marginal)			
11	C (Weak)			
12	C- (Weak)			
13	D (Poor)			
14	E (Under Regulatory Supervison)			
15	F (In Liquidation)			
16	S (Rating Suspended)			

2 DETERMINE IF THE LIFE INSURANCE COMPANY ADHERES TO AN OFFICIAL SET OF ETHICAL STANDARDS.

Each carrier adheres both to its own ethical practices and to basic guidelines dictated by each state's respective insurance department. (You can find a directory of each state's insurance department at www.lifeinsurancetoolbook.com.) If you can't find the insurance company listed among your state's insurance department records, run the other way.

3 CHECK TO SEE IF ANY COMPLAINTS HAVE BEEN FILED AGAINST THE LIFE INSURANCE COMPANY.

Every company—insurance or otherwise—has complaints against it. And the Web makes it exponentially easier for all of us to air our grievances. Because most life insurance carriers aren't going to have spotless records, the trick is for you to see *how many* complaints have been logged against them and *of what nature*. If, for example, you find that a company has multiple, recent, frequent complaints that indicate it is uncomfortably aggressive during a policy's initial **contestable** period (usually the first two years), there may be cause for concern. The same goes if it looks like beneficiaries have a particularly tough time receiving death benefits promptly.

Each state's department of insurance maintains data on the number of complaints filed against an insurance company, as well as pending class-action lawsuits. To find your state's department of insurance, visit www.lifeinsurancetoolbook.com or go to the website of the National Association of Insurance Commissioners (NAIC) at www.naic.org. Then run an online search for the company's name to see if any negative comments exist on unofficial complaint sites.

4 WORK IT OUT.

On the next page, you'll find a five column worksheet to use as you're gathering information about various life insurance companies. Feel free to take the setup from this worksheet and create your own if you decide to substantively research more companies. Answer the questions in the "Ratings" category of the worksheet the best you can.

	COMPANY A:	COMPANY B:	COMPANY C:	COMPANY D:	COMPANY E:
Website/ Phone					
A.M. Best Rating					
Fitch Rating					
Moody's Rating					
Standard & Poor's Rating					
Total Admitted Assets					
Total Liabilities					
Separate Accounts					
Total Surplus & AVR					
5 Yr Investment Yields					
Total Income					
Net Premiums Written					
Net Operating Earnings					
Notes: Complaints, etc.					

The financial strength of a life insurance company is highly important because a life insurance policy is a long-term investment. Life insurance companies are evaluated by ratings services and represent their independent opinions after evaluating a company's financial condition and operating performance, using their specific criteria. The ratings agencies assign ratings of a company's financial strength and ability to meet obligations to policyholders. Some insurance companies are not rated by all of the rating services. (For further information on ratings and contact information for the rating's services, please visit the ratings area on my main website at www.lifeinsurancetoolbook.com.)

Now it's time to choose an agent or adviser who will serve you best in applying for the type of policy you've determined you want to buy.

STEP 5

Choosing an Agent or Adviser

Now that you've got some life insurance companies in mind, it's time to consider how to go about choosing a qualified life insurance adviser to help you weed through the options best for you—if, that is, you decide to work with an adviser. I recommend it; otherwise you won't get as objective an opinion as you'll need. If, however, you are very comfortable with your understanding of the prior chapters, going to a website that offers term comparisons can work for you. Keep in mind that companies currently don't offer lower premiums depending on who or how a policy is obtained.

But it's not always as simple as it sounds when it comes to finding a qualified adviser.

The truth is, life insurance historically has been sold and serviced by professionals dedicated solely to life insurance products. In today's economy, however, this has become rare. Almost all insurance salespeople are now called by such titles as financial adviser, financial consultant, and financial planner.

The agent system has also changed. Years ago, almost all agents were what are called **captive,** which means they sold products exclusively for the company with which they were affiliated. Today, the majority are brokers who represent multiple carriers. Some **captive** agents do sell other companies' products; others, however, still sell only their own products. This is important to find out and be aware of. The advisers you choose from should represent multiple companies. If they represent only one company they can offer you only that company's products—not necessarily the best products in the marketplace. This is one more reason for you to shop around.

With that in mind, here's how this step is going to work. It's fairly short and simple. First, I'm going to give you some advice on adviser-referral services, which you can use to narrow down advisers in your area and which will give you some qualifications to look for. Then I'll provide you with some worksheets (just like in step 4) that can (1) help you further vet your prospective advisers before you meet with them and (2) provide you with some insight on what to look for from an adviser during and after a meeting.

STATE INSURANCE DEPARTMENT COMPLIANCE

Any person selling life insurance must be licensed. As with an attorney needing to pass the bar in any state in which he/she intends to practice, life insurance salespeople are required to pass an exam administered by each state's department of insurance, as well as to enroll in continuing education seminars on a regular basis. *The representative you ultimately select must be licensed in the state where you, the insured, either work or live.* You can find a directory of these departments on www.lifeinsurancetoolbook.com. The resources and compliance standards within state insurance departments can sometimes be more lax in some states than in others. On most state insurance departments' websites, you can research whether an insurance representative is licensed.

1 FIND AN ADVISER.

The following are three good places to start when you're looking for an adviser. Keep in mind that websites change, so if you can't find what you're looking for based on the website navigation I provide, just keep digging around a bit and you'll sure to find it.

Society of Financial Services Professionals (SFSP) | www.financialpro.org

Profile

The SFSP—an organization I'm proud to be a part of—started off as an alumni organization for Certified Life Underwriters (CLU) and Chartered Financial Consultants (ChFC). (More on what those terms mean in a moment.) It has since expanded to include many other types of financial service professionals.

How to use the online referral service

1. Visit www.financialpro.org.
2. Click on the button on the homepage that reads "Consumer: Find a Professional."
3. A page should then open with a link that reads "Find a Credentialed Professional Now!" Click the link.
4. A page with a few fields should open up. Here you can enter the name of an adviser you're interested in knowing more about. If you don't know a name yet, skip the "Name" fields and enter your city, state, and zip code in the respective fields.
5. Below those fields, you should find two menus. The first prompts you to select a specialty. Select "Individual Insurance (Life, Health, Disability)." The second prompts you to choose a product. Choose "Life Insurance."

6. Click "Search." A list of names should come up. Included next to each name are (1) that adviser's professional designations (CLU, ChFC, etc.), (2) the company the adviser works for, and (3) how many years that person has been a member of the SFSP. (The more years the better, but don't let this be your sole qualifier.)

7. When you click on the name itself, you'll find the Adviser's office location and contact information, his or her specialties, and the products he or she provides.

The Life and Health Insurance Foundation for Education | www.lifehappens.org

Profile

The Life and Health Insurance Foundation for Education is an excellent organization that provides a wide variety of useful information. Its online referral service is funneled from the National Association of Insurance and Financial Advisers (NAIFA) database (www.naifa.org), whose standards are not as stringent as those of the SFSP. The database is useful, nonetheless, and you can check out NAIFA's website to get a better understanding of its own standards.

How to use the online referral service

1. Visit www.lifehappens.org.

2. Click on the button in the top menu that reads "Getting Coverage." A menu should pop up.

3. Select "Through an Agent" from the menu, then "Agent Locator" from the submenu. A page should open that gives you the option of searching by name, zip code, or city. Select the method of your choice, enter any appropriate information in the search fields, and click "Submit."

4. A list of names should come up. The adviser's contact information should be included, along with his or her name. Unlike the SFSP adviser locator, professional designations (CLU, etc.) aren't included here. But if you get in touch with one of the advisers listed, be sure to ask about his or her designations.

WHAT DO ALL THOSE PROFESSIONAL DESIGNATIONS MEAN?

Life insurance agents may earn such professional designations as Chartered Life Underwriter (CLU) and Life Underwriter Training Council Fellow (LUTCF). Agents who also are financial planners may carry such credentials as Chartered Financial Consultant (ChFC), Certified Financial Planner (CFP), or Personal Financial Specialist (CPA–PF). These designations indicate that the agent has completed advanced training, passed rigorous exams, and is serious about professional development. But the CLU is the only one that specifically focuses strictly on life insurance and is by far the most comprehensive in the life insurance area. I strongly suggest that the adviser you pick should hold at least this distinction. Find out if an agent has a CLU designation at www.designationcheck.com

SPECIAL NOTE FOR SENIORS

The California Department of Insurance has updated the California Insurance Code to establish several conditions for and acceptable Senior Designation. Information on this code section and a list of acceptable and unacceptable designations can be found at www.lifeinsurancetoolbook.com (resources section: consumer/regulatory) or on the California Department of Insurance website at: http://www.insurance.ca.gov/0200-industry/0050-renew-license/0300-cont-education/Senior-Designations.cfm.

Financial Industry Regulatory Authority (FINRA) | www.finra.org

Profile

If you have a **Variable** policy or have chosen to purchase one, it's not a bad idea to visit FINRA's website. FINRA oversees variable life insurance products, and it is generally tougher with the representatives it oversees. You can research whether an insurance representative is licensed on the FINRA website. Note that with variable insurance products, advisers have to be licensed with both FINRA and their state insurance department.

How to use the online referral service

1. Visit www.finra.org.
2. Click on the link to the right that reads "More About FINRA."
3. Next, click the link to the left that reads "FINRA Member Firms."
4. Click the "List of Members" link. Here you'll find an alphabetical listing of FINRA member firms, with address and contact information.

Beware of **rogue-designated** advisers. These designations can be earned through taking simplified courses over the Internet or by attending a weekend seminar. In other words, these do not require any level of in-depth studying. However, they may be close enough in name or sound impressive enough to imply mastery of a certain subject. This has become a source of concern for regulators and U.S. legislators. Bottom line: if your life insurance adviser doesn't have any of the professional designations I've listed, beware. And check out Question 61 in *Questions and Answers on Life Insurance* to find a copy of the code of life insurance ethics from The American College—an organization that issues CLU designations.

2 COMPARE AND ANALYZE INFORMATION

Use the following guides as you conduct your research and after you come home from an initial meeting to track information on each of the advisers you are considering. I recommend that you meet with at least three potential advisers, so I've provided opportunities to compare information on three advisers.

Adviser Information

Adviser 1

Name: ______________________________

Company (if applicable): ______________________________

Office address: ______________________________

Office phone number: ______________________________

E-mail address: ______________________________

What services other than life insurance does the adviser provide?

____

____

Adviser 2

Name: ______________________________

Company (if applicable): ______________________________

Office address: ______________________________

Office phone number: ______________________________

E-mail address: ______________________________

What services other than life insurance does the adviser provide?

____

____

Adviser 3

Name: ______________________________

Company (if applicable): ______________________________

Office address: ______________________________

Office phone number: ______________________________

E-mail address: ______________________________

What services other than life insurance does the adviser provide?

____

____

Adviser Analysis: Experience, Licenses, Professional Designations, and Associations

	ADVISER 1	ADVISER 2	ADVISER 3
Last name			
Years of experience			
Employed by life insurance company or independent/part of an advisory firm? (Employed or Independent)			
Licensed with state insurance department? (Yes or No)			
Any issues noted in state insurance department's records? (Yes or No; make notes in comments section below.)			
A Certified Life Underwriter (CLU)? (Yes or No)			
A Life Underwriter Training Council Fellow (LUTCF)? (Yes or No)			
A Chartered Financial Consultant (ChFC)? (Yes or No)			
A Certified Financial Planner (CFP)? (Yes or No)			
A Personal Financial Specialist (CPA–PF)? (Yes or No)			
Do you suspect the Adviser is "rogue-designated?" (see page 50)			

Additional comments:

Before You Meet, Remember:

- A good deal will still be there tomorrow.
- If you used part I of this workbook to examine your personal needs and your health situation, bring that information with you.
- If it looks too good to be true, then it probably is.
- Practice saying NO.
- Don't sign anything until you've had adequate time to review the material.
- Inform the Adviser that you need to go over the material with someone else first. If he or she discourages you from this or tells you this is a one-time deal and you have to act now, beware.

After the Meeting

Use this section to reflect on your first meeting with a prospective adviser.

What's your gut feeling? ☐ **Positive** ☐ **Negative**

Explain: ____

____

What happened when you told the adviser you needed to look over the material with someone else?

Explain: ____

____

How did he or she respond? What does his or her reaction tell you about what kind of person he or she is?

Explain: ____

____

How would you rate that adviser on a scale of 1 to 5, where 1 means not attentive at all to your personal needs and 5 means very attentive? ☐ **1** ☐ **2** ☐ **3** ☐ **4** ☐ **5**

How did you feel about the adviser's level of attentiveness (or lack thereof) to your basic personal financial information, assets, and debt with regard to how that information informed his or her recommendations to you?

Explain: ____

____

How did you feel about the costs of each policy discussed? Did the potential premiums look like they'd fit your price range?

Explain: ____

____

Was everything presented in writing? In other words, was the adviser able to adequately and concretely demonstrate the workings of each policy, and to explain what everything on any proposals or illustrations meant?

Explain: ____

____

Did the adviser seem honest, authentic, and transparent? If the attention was more on you and your needs than selling you a policy before you walked out the door, it's a good sign. If the adviser didn't know an answer to your question, did he or she weasel out of it, or did he or she admit to not knowing the answer?

Explain your general experience with the adviser in this regard: ______________________

____

____

Basic litmus test: If five friends asked you to recommend a life insurance adviser, would you recommend this person? ☐ **Yes** ☐ **No** ☐ **I don't know.**

Notes

Use this space to remark on the general pros and cons of the adviser or anything else you've found during your research or during your initial meeting.

____

____

____

____

____

____

Choosing an adviser may be the most challenging decision you make. It's best to choose the adviser based on who recommends him or her. For instance, if a well-known estate planning attorney refers someone to you, that will carry more weight than a recommendation from someone you run into playing tennis or from a friend/relative of the person who's being recommended. Just because an agent or adviser is referred by someone you know doesn't mean he or she is qualified. If this doesn't make sense, think of Bernie Madoff!

The next step details specific policy components and riders you might want to consider.

STEP 6

Selecting Policy Components and Riders

You've given a few life insurance companies a good look, and—if you've decided to work with an adviser—you've now got a much better idea of what a qualified provider looks like.

But you haven't made your final purchase decision just yet, and for good reason: A life insurance company's sales materials and an adviser's expertise can help steer you in the right direction, but choosing your beneficiaries, selecting the policy riders that match your needs, and preparing yourself for the underwriting process is ultimately up to you.

So let's work on each of these three points. First, we'll look at what to think about when choosing a beneficiary—particularly how to ensure that your policy's death benefit is distributed the way you want it to be. Then, you'll get a chance to consider and work through the wide variety of policy riders at your disposal. Finally, I offer a checklist for the application process, along with some tips for preparing for your physical.

1 CHOOSE YOUR BENEFICIARY OR BENEFICIARIES.

A **beneficiary** is the person you designate to receive the funds in your policy in the event of your death. You can name both a primary and a contingent beneficiary and, if you wish, multiple primary and contingent beneficiaries. The death benefit goes to the contingent beneficiary in case your primary beneficiary is also deceased upon your death.

How you choose your beneficiary (or beneficiaries) will depend on your situation and on the laws of your state. I'm not an attorney—always check with legal counsel if you want to be sure—but I do know these basics:

- Life insurance proceeds typically avoid probate and are distributed straight to your beneficiary.
- Life insurance proceeds are usually not subject to income tax.

Proceeds may be subject to the federal estate tax, if it's in effect at the time of your passing and if your estate is substantial enough to be affected by it. It is advisable to work with an estate planning attorney and have a will drawn up—and a trust if the attorney determines it might cushion the financial blow of an estate tax (In my opinion, only an attorney who specializes in this subject should handle estate planning. Beware of living trust seminars and non-legal professionals who peddle living trusts.)

When you do meet with the estate-planning attorney, you should discuss your life insurance. If you already have drawn up a will or a trust, you should call your attorney prior to applying for insurance. If you do not have either document, you can change the owner and beneficiary of your life insurance policy at any time.

Do you already have beneficiaries in mind? If so, list them here:

Primary Beneficiary: ____________________

Primary Beneficiary 2 (if applicable):____________________

Further Primary Beneficiaries (if applicable):____________________

____

Contingent Beneficiary: ____________________

Contingent Beneficiary 1 (if applicable): ____________________

Further Contingent Beneficiaries (if applicable): ____________________

____

If you have multiple beneficiaries, you can explicitly define how you'd like the death benefit distributed in case he or she passes before you do. Select which of the following two methods you prefer:

- ◯ **Per Capita.** If your primary beneficiary dies before you do, the remaining beneficiaries will equally divide that share of the proceeds in addition to receiving their own shares either (1) by head or by individual or (2) to share equally when you pass away.

- ◯ **Per Stirpes.** If your primary beneficiary dies before you do, that beneficiary's share of the proceeds will pass to that person's heirs rather than to the remaining beneficiaries when you pass away. It's a method of dividing benefits among living members of a class of beneficiaries and the descendants of deceased members. Since you won't be around to clarify, it's especially important with this option to ensure that all documents are clear, concise, unambiguous, and error free. If you have a child under the age of 18 and you name him or her as a beneficiary, whoever has physical guardianship will typically have financial guardianship. That may not be what you prefer. That's why I recommend you consult with an estate planning attorney to document your wishes.

It's also important to consider the unfortunate possibility that you and your primary beneficiary die simultaneously, such as in a car crash, and it cannot be determined who died first. In some states, the proceeds are paid as if the primary beneficiary died first. Therefore, the contingent beneficiary would receive the proceeds. If there were no contingent beneficiary, the proceeds would become part of the insured's estate. Make sure you know the particulars in your given state.

2 IDENTIFY APPROPRIATE RIDERS.

A policy rider is an optional benefit that can be added to a policy for an extra premium. Legally, it is defined as a document that amends the policy or certificate. It may increase or decrease benefits, waive the condition of coverage, or in any other way amend the original contract.

The following checklist will help you determine which policy riders would be most appropriate for you to consider. Put a check next to the statements that apply to you and read the corresponding note on possible riders.

WHO SHOULD I NAME AS THE POLICY OWNER?

Choosing a policy owner is a process quite similar to choosing beneficiaries. Typically, you are the owner (at least in community property states). I am not as familiar with how this works in separate property states because my practice has been limited to community property states. Separate property states observe different **estate planning practices.**

It is not necessary to engage an attorney at this stage if you simply wish to research the ownership issues yourself. A good place to start your research is with Nolo Press: www.nolo.com or 800-728-3555. When you are not listed as the policy owner, it is generally for specific reasons, such as for estate planning purposes.

- I would like to have access to my death benefit prior to my death if I am diagnosed with a terminal illness.

  You may be interested in an Accelerated Death Benefit rider, which allows payment of a portion of the face amount before your death if you're diagnosed with a terminal illness or injury.

- I would prefer that my beneficiaries receive an increased death benefit if I pass away as the result of an accident.

  You may be interested in an Accidental Death Benefit, which provides a benefit in addition to the face amount of a policy, payable if you die as a result of an accident. Sometimes this is referred to as a Double Indemnity rider.

- I have (or will have) a permanent policy and would trade a smaller cash value and smaller premium for added term insurance to cover specific needs.

  You may be interested in an Annual Renewable Term rider. This is term life insurance that is "blended" into the policy, which reduces the premium and will reduce the cash value.

- I have children and am interested in covering their untimely passing.

  You may be interested in a Child rider. This provides insurance coverage for your children.

- I would prefer that my death benefit increase with annual increases in the Consumer Price Index (inflation).

  You may be interested in a Cost-of-Living rider. This allows you to purchase one-year term insurance equal to the percentage change in the consumer price index with no evidence of insurability.

- I would prefer that my beneficiaries have access to some of my death benefit in the instance that I develop a permanent disability.

  You may be interested in a Disability Income rider. This is more common with older policies, but this type of rider typically pays a monthly benefit of 1 percent of the death benefit in the event that you become permanently and totally disabled.

- I would like to purchase additional coverage at certain intervals without providing evidence of insurability (no additional underwriting).

  You may be interested in a Guaranteed Insurability option.

- I would like to be able to collect part of my life insurance benefits prematurely to pay for medical care in the unfortunate event of a catastrophic disease or illness.

  You may want to consider a Living Benefits rider (also known as a Terminal Illness rider).

- I would like to insure an eligible business or other family member.

  You may want to consider an Other Insured rider.

- I would like to insure my spouse or domestic partner.

  You may be interested in a Spousal rider. Check with your local and state regulations, a life insurance adviser, or with an attorney if you're considering covering a loved one not legally considered a "spouse."

- I would like to have the cost of insurance waived in the event that I become totally and permanently disabled?

  You may want to consider a Waiver of Cost of Insurance rider. This option is most common in universal life policies.

- I would like to have premiums waived in the event that I become totally and permanently disabled before a specified age.

  You may want to consider a Waiver of Premium rider. These are most common with term and whole life policies.

Keep in mind that each carrier offers only certain riders per policy and may offer different riders than those listed above. And don't make a decision to add any rider too hastily. Remember, many of these riders are more profitable for the insurance carrier than for you as the insured.

3 APPLY FOR THE POLICY.

Now that you've considered your beneficiaries and policy riders, it's time to begin the actual application process. Follow this step-by-step checklist to get the process moving.

1. Complete your application and any required forms. Most companies will offer conditional or limited coverage up to a set amount of coverage before the actual policy initiation date if you've evidenced insurability.

TIPS FOR PREPARING FOR YOUR UNDERWRITING PHYSICAL

I'm no physician, but here are some medical underwriting tips, based on my long experience and many discussions with underwriters. Bookmark this checklist and work through it when your examination approaches.

- **Relax**. Insurance companies are looking for average people, not superhumans.
- **Watch what you eat.** It's best not to eat for 8 hours prior to the examination and to avoid caffeine. Schedule a morning examination if at all possible, when you're more likely to be relaxed. Being relaxed helps produce positive readings of blood pressure and electrocardiogram (EKG) levels.
- **Avoid alcohol.** Alcohol tends to elevate blood pressure for 12 to 24 hours. Avoid drinking alcoholic beverages for at least 24 hours prior to the examination.
- **Get a good night's rest** before the exam.
- **Give a urine specimen before a blood pressure check.** The elimination of fluids tends to moderately lower blood pressure.
- **Avoid smoking.** If you are a smoker, don't smoke at all within thirty minutes of the exam. Smoking tends to elevate blood pressure by constricting the artery walls.
- **Avoid salt.** Salt retains fluids. Avoid it or use it very lightly for 3 or 4 days prior to the examination. This can have a beneficial effect on your blood pressure.
- **Discuss any potential problems with your adviser** prior to the examination. This can affect your adviser's recommendations, such as which company or companies to apply to and how to prepare for the underwriting process. The Adviser might want to discuss your case informally with the underwriter before you apply. In some cases, this can be beneficial. Also be certain the examiner correctly lists the location of doctors and hospitals that you have seen in the past, since the insurance company will most likely request their reports.

○ 2. Compile a list of all physician and medical group names. Be sure to include contact information, dates consulted, and purpose/outcome for each. Also include a list of all prescription and non-prescription medications and their dosages, as this information may be needed for the application, exam, or personal history interview.

○ 3. Submit your application to the life insurance company for underwriting consideration. This will typically take 4–6 weeks, but it can take months if you're requesting a large amount of coverage and/or if you have a complex medical history.

4. Prepare for your physical. (Review the "Tips for Preparing for Your Underwriting Physical" on page 61.) Most insurance companies require some type of paramedical exam during the application process; this usually consists of a height/weight check, blood pressure check, and blood and urine specimens. The exam is often more comprehensive at older ages and for larger amounts of coverage and can include a more thorough exam by a medical doctor. (Again, consult the checklist for tips on how to prepare for a medical exam.)

5. Order your medical records. This can take 3–4 weeks depending on your physician/medical group.

6. Prepare for a personal history interview. This is a phone interview done through a third party that verifies information provided on the application and paramedical exam and additional questions from the underwriter. The company is making sure that all questions are answered consistently. Make sure you've got your ducks in a row on this one.

7. Complete any additional questionnaires. These are often required for specific medical conditions and hazardous work-related activities and hobbies.

8. Make the final decision. After the underwriting steps are completed, either an offer of coverage will be made or coverage will be declined. If your application is rejected, make sure it's crystal clear to you why you were denied coverage. Sometimes miscommunications regarding your health (inaccurate health records, for example) could hamper your acceptance.

Note that an underwriter bases his or her decision on the information received, and sometimes decisions can be changed with additional information. And remember that different companies treat some specific conditions differently, so your rate classification can vary from company to company. If you've been denied coverage, or if you're not happy with an offer, you should consider a second opinion.

Now you're all set. But policies by no means begin and end at the dotted line. From this point forward, we'll be looking at how to monitor in-force policies after purchase (and what to consider when deciding to replace a policy or terminate it altogether.) Part III is useful, especially if you're new to life insurance. It contains essential information about life insurance terminology and how to really dig in to the moving parts of a policy. I highly recommend that you read it before you commit to a life insurance contract.

PART III

UNDERSTAND, MAINTAIN, AND MONITOR YOUR POLICY OR TERMINATE IT

STEP 7

Assessing and Monitoring Your Policy

Life insurance doesn't end at purchase. Policies are living things, and there are many components that can affect their performance.

This is particularly true with **permanent** policies that build cash value over time. For example, if you've taken out **policy loans** or have a **Universal/Variable/Equity Indexed, etc.** policy—which, as you saw in step 2, requires vigilant attention to **premium** payments and the investment portfolio—you'll want to be very aware of how much money it'll take to keep those policies **in-force**, and whether you can afford to *keep* them **in-force**.

Term insurance, on the other hand, is a little less complicated. But you'll still want to know things like:

1. If you can get a reduced premium while maintaining the **face value** of the policy if your health or overall fitness has demonstrably improved since the policy was activated

2. If the policy will still be affordable to keep **in-force** if you decide that you need to renew it

3. If you can get a cheaper premium should you want to reduce the face value because, for example, the need you originally insured for (like a debt or a mortgage) has been substantially minimized since your policy was activated

4. If you can get a reduced premium if riders attached to your original life insurance contract are no longer relevant or desired (A rider is an optional benefit that can be added to a policy for an extra premium. For example, you may have added a **rider** that provides insurance coverage for your children. If your children are all grown up, the rider may no longer be necessary.)

5. If the life insurance company is still performing well financially

Steps 7 and 8 will help you work through your options if you decide to choose to replace your current policy with an alternative policy or to terminate a current policy. But first, we'll look at how to understand the language used in in-force illustrations (sometimes called **premium schedules** with term policies), which is the tool—the dashboard, if you will—of life insurance monitoring.

The first question to answer is, what type of insurance do you have—or, if you're new to this subject, do you want to purchase? Check one of the following:

- ◯ **Term life insurance**
  (continue to the next section, called "Term Life Insurance Monitoring")

- ◯ **Permanent life insurance**
  (skip to the section called "Permanent Life Insurance Monitoring" on page 71)

RATINGS:
See step 4 for more information.

ISSUE DATE:
This is the date your policy became effective and was issued by the insurance company.

INSURANCE AGE:
This is your official age, as determined by the insurance company, upon the effective start date of your policy.

PRIMARY BENEFICIARY:
This is your primary beneficiary.

CONTINGENT BENEFICIARY:
If applicable, this is your contingent (or secondary) beneficiary who would receive the proceeds of your policy should your primary beneficiary predecease you.

FACE AMOUNT:
This is the amount your beneficiaries would receive in the event of your death (less any policy loans outstanding).

Term Life Insurance Monitoring

To begin the monitoring process, if you don't have your policy, with its data pages and schedules of current and guaranteed premiums, get in touch with your life insurance carrier and request a current premium schedule. Fill in the worksheet below with the information you already know—which should be the majority of it—but edit it as necessary once the illustration arrives.

Basic Information

Your name/policy owner: ______________________________

Insurance carrier: ______________________________

Ratings (*see* step 4 for more information about ratings):

- Current A.M. Best rating: ________

  If rating has changed since purchase, is the change

  ☐ **positive** or ☐ **negative**?

- Current Fitch rating: ________

  If rating has changed since purchase, is the change

  ☐ **positive** or ☐ **negative**?

- Current Moody's rating: ________

  If rating has changed since purchase, is the change

  ☐ **positive** or ☐ **negative**?

- Current Standard & Poor's rating: ________

  If rating has changed since purchase, is the change

  ☐ **positive** or ☐ **negative**?

Policy number: ______________________________

Issue date: ____________________ Insurance age: ________

Primary beneficiary: ______________________________

Contingent beneficiary: ______________________________

Face amount/Maximum death benefit: $ ________________

PREMIUM MODE:

This is how often you pay your premium (monthly, quarterly, etc.).

MODAL PREMIUM:

This is the dollar amount for your periodic premium payment.

ANNUALIZED CURRENT PREMIUM:

This is the annual sum of your monthly or quarterly premium payments (if you don't already pay annually).

PREMIUM (IF SWITCHED TO ANNUALLY):

This is the total you'd pay in premiums if you paid once a year. Insurance companies often give a discount on annually paid premiums.

TYPE OF COVERAGE:

This is the type of term life insurance coverage insuring your life.

Changing how often you pay your premium could save you money (it may be a lot!). Almost always, you have a choice of paying premiums monthly, quarterly, semiannually, or annually. Insurance companies typically charge extra when you pay other than annually. The formula used to calculate the extra charges per year is expressed as an annual percentage rate and in dollars. (More information can be found in Question 66 in *Questions and Answers on Life Insurance*, and an online calculator can be found at www.lifeinsurancetoolbook.com in the resources section.)

Premium mode:

☐ **Monthly** ☐ **Quarterly** ☐ **Semiannually** ☐ **Annually**

Modal premium: $ ____________________

Annualized current premium: $ ____________________

Premium (if switched to annually): $ ____________________

How much could you save if you switched to an annual premium (if not already annual)?: $ ____________________

Did less-than-ideal health or fitness prevent you from getting standard (preferred) rates when you purchased the policy? ☐ **Yes** ☐ **No**

(If yes, has your health of fitness demonstrably improved since the policy went **in-force**?) ☐ Yes ☐ **No**

Type of Coverage

Which type of term policy do you have? (Check all that apply.)

○ Annual Renewable Term (ART)/Yearly Renewable Term (YRT)

○ Level Premium Term (Complete questions below if checked.)

1. For how many years of the policy will the premium remain level? _________
2. How many years in the level premium period are remaining? _________
3. Are the premiums **guaranteed** level for that period? ☐ **Yes** ☐ **No**

RE-ENTRY:

If applicable, this is the year when you will need to re-qualify for preferred rates.

- ◯ Decreasing Premium Term (Complete questions below if checked.)

1. Which kind of debt or financial commitment did you use the insurance to cover?

   ☐ **Mortgage** ☐ **Student debt** ☐ **Credit card debt**

   ☐ **Other (**If "other," use this space to explain.)

   ____

   ____

2. Have you significantly paid off that debt or financial commitment since the policy was activated? ☐ **Yes** ☐ **No**

   If "yes," how necessary do you believe it is to maintain this policy as is?

   ☐ **Very necessary** ☐ **Not necessary** ☐ **I don't know**

- ◯ Return of Premium Term

1. After which year does this policy begin to generate a cash value? ______________

2. Has this policy begun to build cash value as laid out in the original pro-forma illustration? ☐ **Yes** ☐ **No**

3. How much cash value will it generate in all? $ ______________________

Answer the following questions regardless of which type of term policy you've checked.

1. Is there a **re-entry** term premium rate available upon policy expiration? ☐ **Yes** ☐ **No**

2. What is the **maximum** re-entry term premium rate?

   $ ______________________

3. Does the re-entry premium require full requalification?

   ☐ **Yes** ☐ **No**

4. Does re-entry come with a new **contestable** period? ☐ **Yes** ☐ **No**

5. By what date are you required to apply for re-entry, if you choose to do so? ___/___/20___

6. Do you consider this re-entry rate affordable? ☐ **Yes** ☐ **No**

7. Does the policy provide the option to **convert** to **permanent** insurance after a certain year? ☐ **Yes** ☐ **No**

8. By what date are you required to apply for conversion, if you choose to do so (this is known as the **last conversion date)**? ___/___/20___

9. List the riders, if any, you added to your policy, along with how much extra those riders cost in premiums per premium payment and your assessment of whether the rider is still necessary or desired.

   - Rider 1: $ ____________________

     Still necessary? ☐ **Yes** ☐ **No**

   - Rider 2: $ ____________________

     Still necessary? ☐ **Yes** ☐ **No**

   - Rider 3: $ ____________________

     Still necessary? ☐ **Yes** ☐ **No**

   - Rider 4: $ ____________________

     Still necessary? ☐ **Yes** ☐ **No**

CONTESTABLE PERIOD:

This is a period of time (usually the first 2 years of a policy) during which the insurance company can revoke your policy.

LAST CONVERSION DATE:

This is the date by which you must convert your term life insurance to permanent life insurance—if you choose to do so—without evidence of insurability.

RIDERS:

These are optional additions to the primary policy (to insure a child, for example).

Notes

NOTE: Skip to the next chapter (step 8) if you are considering replacing a term policy with a permanent life insurance policy.

Permanent Life Insurance Monitoring

To begin the monitoring process, get in touch with your life insurance carrier and request a current in-force illustration. You can use the letter template below to request the in-force illustration. Note in particular the items in italics. These are the two primary issues you'll want to address when monitoring a permanent life insurance policy. While you are waiting for a response from your insurance company, fill in the worksheet (which follows the sample letters provided) with the applicable information you already know. Your original sales illustration and policy are appropriate sources, but edit them as necessary once the in-force illustration arrives.

Note: There are separate in-force letters for each type of permanent policy (whole life, Universal Life, Equity Indexed, and Variable Life). An in-force illustration is necessary for all permanent/cash value policies. The following are sample request letters for you to adapt and use.

[In-force request letter (whole life)]

Date

Attn: Policy Owner Services

[Carrier Name] and [Address]

Re: [Policy Number], [Insured Name], [Owner Name, if different than insured name]

Dear Sir or Madam:

In reference to the life insurance policy (policies) captioned above for which I am the policy owner, please provide these two in-force proposals [Note: depending on your situation, you may need additional in-force proposals]:

1. *Illustrate to maturity with current premiums based on current dividend scale (or interest rate) and mortality assumptions.*
2. *Illustrate to maturity the minimum premium required to endow the policy at maturity based on current dividend scale (or interest rate) and mortality assumptions.*

Please also indicate the current surrender value, loan value, and the cost basis in the policy to date. Please call me if you have any questions, and thank you for your prompt attention to this matter.

Sincerely,

[Your printed name and signature]

[In-force request letter (Universal Life)]

Date

Attn: Policy Owner Services

[Carrier Name] and [Address]

Re: [Policy Number], [Insured Name], [Owner Name, if different than insured name]

Dear Sir or Madam:

In reference to the life insurance policy (policies) captioned above for which I am the policy owner, please provide these two in-force proposals [Note: depending on your situation, you may need additional in-force proposals]:

1. *Illustrate to maturity with current premiums based on current interest rate and mortality assumptions.*
2. *Illustrate to maturity the minimum premium required to endow the policy at maturity based on current interest rate and mortality assumptions.*

Please also indicate the current surrender value, loan value, and the cost basis in the policy to date. Please call me if you have any questions, and thank you for your prompt attention to this matter.

Sincerely,
[Your printed name and signature]

[In-force request letter (Equity Indexed/Variable Life)]

Date

Attn: Policy Owner Services

[Carrier Name] and [Address]

Re: [Policy Number], [Insured Name], [Owner Name, if different than insured name]

Dear Sir or Madam:

In reference to the life insurance policy (policies) captioned above for which I am the policy owner, please provide these two in-force proposals [Note: depending on your situation, you may need additional in-force proposals]:

1. *Illustrate to maturity with current premiums based on a gross hypothetical return rate of XX% and current mortality & expense assumptions.*
2. *Illustrate to maturity the minimum premium required to endow the policy at maturity based on a gross hypothetical return rate of XX% and current mortality & expense assumptions.*

Please also indicate the current surrender value, loan value, and the cost basis in the policy to date. Please call me if you have any questions, and thank you for your prompt attention to this matter.

Sincerely,
[Your printed name and signature]

RATINGS:

See step 4 for more information.

ISSUE DATE:

This is the date your policy became effective and was issued by the insurance company.

INSURANCE AGE:

This is your official age, as determined by the insurance company, upon the effective start date of your policy.

PRIMARY BENEFICIARY:

This is your primary beneficiary.

CONTINGENT BENEFICIARY:

If applicable, this is your contingent (or secondary) beneficiary who would receive the proceeds of your policy should your primary beneficiary predecease you.

FACE AMOUNT:

This is the amount your beneficiaries would receive in the event of your death (less any policy loans outstanding).

PREMIUM MODE:

This is how often you pay your premium (monthly, quarterly, etc.).

MODAL PREMIUM:

This is the dollar amount for your periodic premium payment.

ANNUALIZED CURRENT PREMIUM:

This is the annual sum of your monthly or quarterly premium payments (if you don't already pay annually).

Note to workbook user: the hypothetical return rate used should be conservative (on the lower side).

Basic Information

Your name/policy owner: ____________________

Insurance carrier: ____________________

Ratings (*see* step 4 for more information about ratings):

- Current A.M. Best rating: ________

  If rating has changed since purchase, is the change

  ☐ **positive** or ☐ **negative**?

- Current Fitch rating: ________

  If rating has changed since purchase, is the change

  ☐ **positive** or ☐ **negative**?

- Current Moody's rating: ________

  If rating has changed since purchase, is the change

  ☐ **positive** or ☐ **negative**?

- Current Standard & Poor's rating: ________

  If rating has changed since purchase, is the change

  ☐ **positive** or ☐ **negative**?

Policy number: ____________________

Issue date: ____________________ Insurance age: ________

Primary beneficiary: ____________________

Contingent beneficiary: ____________________

Face amount/Maximum death benefit: $ ____________________

Premium mode:

☐ **Monthly** ☐ **Quarterly** ☐ **Semiannually** ☐ **Annually**

Modal premium: $ ____________________

Annualized current premium: $ ____________________

PREMIUM (IF SWITCHED TO ANNUALLY):

This is the total you'd pay in premiums if you paid once a year. Insurance companies often give a discount on annually paid premiums.

TYPE OF COVERAGE:

This is the type of term life insurance coverage insuring your life.

RIDERS:

These are optional additions to the primary policy (to insure a child, for example).

ACCUMULATED CASH VALUE:

This is the most current cash balance of your policy considering no policy loans or withdrawals.

INTEREST RATE:

This is the rate credited on your policy. This rate is applied to your accumulation value, minus any policy loans. Interest is compounded monthly.

LOANABLE VALUE:

This is the amount you may borrow against your accumulated value as of the date of the in-force illustration.

Premium (if switched to annually): $ ____________________

How much could you save if you switched to an annual premium (if not already annual)?: $ ____________________

Did less-than-ideal health or fitness prevent you from getting standard (preferred) rates when you purchased the policy? ☐ **Yes** ☐ **No**

(If yes, has your health or fitness demonstrably improved since the policy went **in-force**?) ☐ Yes ☐ **No**

Type of Coverage

Which type of permanent policy do you have? (Check all that apply.)

- ◯ Whole life
- ◯ Universal Life
- ◯ Equity Indexed
- ◯ Variable Life or Variable Universal Life

List the riders, if any, you added to your policy, along with how much extra those riders cost in premiums per premium payment and your assessment of whether each rider is still necessary or desired.

- Rider 1: ____

  Still necessary? ☐ **Yes** ☐ **No**
- Rider 2: ____

  Still necessary? ☐ **Yes** ☐ **No**
- Rider 3: ____

  Still necessary? ☐ **Yes** ☐ **No**
- Rider 4: ____

  Still necessary? ☐ **Yes** ☐ **No**

Cash Value Health and Performance

What is the current **accumulated cash value**? $____________________

What is the **interest rate**? ________ %

What is the annual rate of return? ________ %

This number is a standard calculation of the rate of return, or you can calculate an internal rate of return calculation. (A calculator for annual rate of return can be found at www.lifeinsurancetoolbook.com.)

What is the policy's **maximum available value**? $____________________

POLICY LOANS:

These are loans taken out against the account. See page 22 for more information on policy loans and their dangers.

LOAN DEBT:

This is the dollar amount borrowed against the policy's accumulated value; it is the sum total of policy loans outstanding.

INTEREST CREDITED OR CHARGED TO THE LOAN ACCOUNT:

This is the net interest credited/charged on any loan debt for the specified period.

NET CASH SURRENDER VALUE:

This is the current cash value of the account, minus any outstanding policy loans or withdrawals against the policy.

WITHDRAWALS:

This is cash taken permanently from the policy, and it cannot be repaid. Typically, the death benefit is reduced on a dollar-by-dollar basis in the amount of the withdrawal.

SURRENDER CHARGE:

This is the charge for early surrender of the policy. This is the difference between the accumulation (or account) value and the net cash surrender value. The surrender charge typically decreases each year and disappears after a certain number of years.

Have **policy loans** been taken against the account? ☐ **Yes** ☐ **No**

If "Yes," what is the cumulative value of the **loan debt** taken out against the account? $____________________

What is the loan interest rate? ________ %

What is the interest credited on the borrowed (loaned) funds?

$____________________

(Note: the insurance company pays a lower rate than its regular dividend/interest rate on borrowed funds; this translates into a net rate on borrowed funds.)

Have all of those policy loans been paid back with interest?

☐ **Yes** ☐ **No**

If "No," what balance remains to be paid, including interest?

$____________________

And what, then, is the **net cash value** of the policy?

$____________________

Have you made any **withdrawals** from this net cash value?

☐ **Yes** ☐ **No**

If "yes," how much? $____________________

What is the current **surrender charge**? $____________________

Is the policy ☐ **participating** or ☐ **non-participating**?

If "participating," what is your dividend option? (Check one.)

- ◯ Cash
- ◯ Purchase of fully paid-up life insurance in small increments with each dividend
- ◯ Reduction of the next premium payment
- ◯ Retention by the company at interest
- ◯ Purchase of one-year term insurance in an amount equal to the then cash value

Is Your Permanent Policy Performing as Expected?

Now for the big questions regarding your policy. Upon reviewing your in-force illustration, answer the following questions:

Is the policy fully funded? ☐ Yes ☐ No

In other words, will it continue to maturity (maximum age) with current premiums based on current assumptions?

- If "Yes," relax and review it again in 2 to 3 years. It looks like everything's going as planned.
- If "No," continue to the next question.

Will the policy lapse prior to the contract maturity date? ☐ Yes ☐ No

- If "No," skip to the last question below.
- If "Yes," what premium are you required to pay to fund the policy to maturity, based on current assumptions? $____________________

  Now answer the next question.

Can you afford to pay this premium? ☐ Yes ☐ No

- If "Yes," great. But you may want to pay back any policy loans or withdrawals outstanding or catch up on premium payments if you'd like to get your premiums back to normal.
- If "No," answer the next question.

Is the policy's expected lapse date acceptable? For example, is the date well past your life expectancy? ☐ Yes ☐ No

- If "No," your policy is in serious danger of lapsing and leaving you short of your goals.

Is the policy *overfunded*? (That is, have you paid more into it than required?) ☐ Yes ☐ No
(This is usually more common with older policies with a long history of premium payments.)

- If "No," you're still in fine shape, as long as the policy is not in danger of lapsing.

- If "Yes," you may want to ask your life insurance company if premiums still need to be paid at all, or if your premium payment can be reduced. This can sometimes be accomplished through a phone call or by an additional in-force illustration request letter.

As part of an annual review, policy owners—especially those who own permanent life insurance policies—should use financial analytics to take a look at the internal rate of return calculation on the cash value buildup. (See Dr. Joseph Belth's method in Question 102 in *Questions and Answers on Life Insurance*.) It is also necessary to understand how the various factors are applied to the policy every month. First, the premium paid is added to the cash value from the end of the prior period. Second, mortality costs and other expense charges are subtracted. Third, interest is credited to this value (after costs). Therefore, the interest credited to the policy is not the actual internal rate of return. The internal rate of return, an important financial yardstick, is almost always less than the current interest crediting rate.

By understanding, maintaining, and monitoring your policy, you will avoid any unpleasant surprises in the future and ensure that your policy will be there when you need it. As a result of your review, however, you might decide to replace a policy. Read step 8 to make sure you make the best possible informed decision you can.

STEP 8

Replacing a Policy

As you gathered in step 7, it's a good idea to review your life insurance policy on a regular basis to make sure you are getting the value you expected in exchange for the premium dollars you pay the life insurance company. Things change in the real world, and your life insurance policy can be affected by such circumstances as policy performance, fluctuations in your life insurance company's financial condition, and newer policies in the marketplace.

And, as we've discussed, your needs sometimes change, too. Perhaps those changes will, in your estimation, warrant a **replacement** of your existing policy.

A replacement may be internal (replacing it with a new policy from the same company) or external (replacing it with a policy from a different company).

Replacement can be a very good idea—or a very bad one. It depends. The traditional viewpoint within the life insurance industry is that replacing an existing life insurance policy with a new one is generally not in the policy owner's best interest. But that's not always the case. In any event, proceed with caution and only commit to a new replacement when it's in your clear and demonstrable interest to do so.

This step will help you in that decision-making process. It's not an exhaustive treatment of the subject, because your individual situation is unique and there is no one-size-fits-all solution. But you'll finish the step being able to evaluate the pertinent facts and circumstances.

Start with the Basic Facts

State law determines the legal meaning of the word *replacement*, and those definitions vary substantially from state to state. It's important to become familiar with your own state's definition of the term. Go to the National Association of Insurance Commissioners' website at www.naic.org and look for the link to your state's insurance department. If the insurance code and replacement regulations aren't on the NAIC website, get in touch with your state's department of insurance to request it, and report the most pertinent findings here:

An equally important question to answer at the start of this process is, what type of insurance do you have—or, if you're new to this subject, do you want to purchase one of the following? Check one:

- ◯ Term life insurance (continue to the next section, called "Term Life Insurance Policy Replacement")
- ◯ Permanent life insurance (skip to the section called "Permanent Life Insurance Policy Replacement" on page 83)

Term Life Insurance Policy Replacement

Term life insurance is relatively simple: If you die while the policy is **inforce**, your beneficiary receives 100 percent of the death benefit. If you die after the policy expires—and if it hasn't been renewed—your beneficiary gets nothing. You know this by now, but the simplicity of it highlights an important point: Apart from getting a better premium, there aren't many wise reasons to replace a term policy. But let's dig into it. First, answer the following questions:

1. What do you wish a new policy to achieve that your existing policy does not?

2. Have you first contacted your life insurance company to see if the policy can be modified to meet your desired objectives? ◯ **Yes** ◯ **No**

   If "No," do that first. If "Yes," and if the company *will not* modify to meet your needs, continue.

Now use the table on page 81 to compare your old policy with a desired replacement policy. Review step 6 for the current financial ratings you recorded for your life insurance company and write them again in the following space. And if you need to jog your memory, refer to step 4 for information on how to find the ratings of the replacement company. Also, be very clear about any disadvantages—like new contestability periods and suicide clauses (these provisions typically run for the first one or two years of a life insurance policy), and any new fees—that may come with replacement.

Now that you've looked at both policies side by side, what's your conclusion? Is the replacement worth it? Does it provide the same value—or more—for less money? Explain.

If, based on your informed decision about whether to replace your policy, you'd like a new policy, be sure to meet with a qualified, ethical insurance adviser to discuss the details. I emphasize *qualified* and *ethical* here because less scrupulous advisers will encourage you to purchase a replacement policy regardless of whether it's advantageous for you to do so because it often means a new commission for them. So, if this is the route you choose, be sure to review step 5 on finding a good adviser.

	Present Policy	Proposed Policy
Company name:		
Ratings:		
A.M. Best rating		
Fitch rating		
Moody's rating		
Standard & Poor's rating		
Type of coverage (check one):		
Whole life		
Universal Life		
Equity Indexed		
Variable Universal Life		
Date of issue:		
Premium detail:		
Annualized premium		
Which has the higher premium? (Check one.)		
By how much?		
How much premium is necessary to guarantee coverage at initial/current levels for the duration of the policy?		

	Present Policy	Proposed Policy
How will the premium payment mode (monthly, quarterly, semiannually, or annually) affect the policy if the premium is to be payable for a certain number of years?		
How many years will the premium need to be paid based on current assumptions?		
How many years will the premium need to be paid based on guaranteed assumptions?		
Cash/Surrender Value—Compare your current policy's projected cash values (based on current assumptions) with the new policy's first-year value. (Note: surrender charges may significantly—if not completely—reduce early values in any new policy.)		
Policy maturity/termination date:		
Is there a term rider on the policy? ☐ **Yes** ☐ **No** If yes:		
What is the ratio of the initial term amount to the total death benefit?		
Does the term rider convert to permanent insurance? ☐ **Yes** ☐ **No**		
If it does convert, when does it do so and is it guaranteed?		
Do the policies have any other riders? If so, list them to the right.		
What are the costs of these riders?		
How much are the setup/administration costs associated with the replacement policy?		

Permanent Life Insurance Policy Replacement

Because of the cash-value element and its complexities, it is much more difficult to analyze a permanent life insurance policy in a potential replacement situation. Use the questions in this step to make the best guesses you can on current assumptions, but remember that it's especially important for you to meet with a qualified, ethical insurance agent when discussing permanent policies. As I mentioned in the discussion about replacing term life insurance policies, I emphasize *qualified* and *ethical* here because less scrupulous advisers will see only a new commission—not what's best for you. So, if this is the route you choose, be sure to review step 5 on finding a good agent or adviser.

As I mentioned in step 2, you have many types of permanent life insurance policies from which to choose. For the purpose of this step, we will use the generic term *permanent life insurance* to mean any type of life insurance that builds up a cash value, including Whole Life, Universal Life, Variable Life, Variable Universal Life, and all variations on each of these policy types.

Keep in mind that different companies use different assumptions in preparing illustrations. Illustrations alone should never be used to compare policies. State insurance regulations require—for your protection—that both the proposed replacing company and your existing company prepare current illustrations for you to consider as you make an intelligent policy replacement decision.

These illustrations will show the effects of the surrender charge on the existing and proposed policies. In situations where the current policy will be modified, but not terminated, comparisons should include **in-force** ledgers of the policy before and after the change, if available. The terms *ledger* and *illustration* mean the same. Some companies use the term *ledger illustration* instead.

Reduced-scale illustrations—illustrations showing lower interest-rate-crediting assumptions—should be provided on both existing and proposed policies to demonstrate the effects of volatility on the performance of non-guaranteed policy elements under varying circumstances. In other words, if an illustration with a lower interest rate than is reasonably thought will be achieved nevertheless shows that the plan will work, there is every indication that it will work in the real world, as long as things don't go completely awry.

The reduced-scale illustrations should be consistent with those required by NAIC model illustration regulations, when applicable in your state. This section is intended for evaluation purposes only and is not a substitute for state replacement requirements. Also, for Variable Life insurance, you will need to look at the sub-accounts and most likely will need the use of an investment analyst.

The term *sub-account* means the funds within a Variable Life or Variable Universal Life policy in which the money is invested. A sub-account is similar to a mutual fund, except that it comes under the umbrella of a life insurance policy. It is, however, highly misleading to think of a Variable Life or Variable Universal Life policy as a mutual fund with a thin layer of life insurance on top. We mention this because that terminology is sometimes used by well-meaning but misguided agents to describe a variable life policy. A better way to think of a Variable Life or Variable Universal Life policy is as a permanent life policy that uses mutual funds (sub-accounts) to manage the cash-value element within the policy.

Illustrations should never be the sole criteria for evaluating a replacement. Illustrated cash values and illustrated death benefits are never reliable predictions of future results. More information is needed. At a minimum, you should attempt to find out what the underlying assumptions are for the in-force illustration on the current policy, and for the sales illustration for the proposed policy. You should be aware that there might be differences in the assumptions used by each company, which might render a comparison based upon such illustrations invalid. Make sure you are comparing apples to apples.

That was an earful, no? It just can't be overemphasized that permanent policies are thorny, and any consideration about replacement must be done with due diligence. This section is only the first step. Speaking of which, let's get started. First answer these two questions.

1. What do you wish a new policy to achieve that your existing policy does not?

   ____

   ____

2. Have you first contacted your life insurance company to see if the policy can be modified to meet your desired objectives? ○ **Yes** ○ **No**

   If "No," do that first. If "Yes," and if the company *will not* modify to meet your needs, continue.

Now use the following table to compare your old policy with a desired replacement policy. Review step 6 for the current financial ratings you recorded for your life insurance company and rewrite them here. And if you need to jog your memory, refer to step 4 for information on how to find the ratings of the replacement company. Also, be very clear about any disadvantages—like new contestability periods and suicide clauses (these provisions typically run for the first one or two years of a life insurance policy), and any new fees—that may come with replacement.

	Present Policy	Proposed Policy
Company name:		
Ratings:		
A.M. Best rating		
Fitch rating		
Moody's rating		
Standard & Poor's rating		
Type of coverage (check one):		
Whole life		
Universal Life		
Equity Indexed		
Variable Universal Life		
Date of issue:		
Premium detail:		
Annualized premium		
Which has the higher premium? (Check one.)		
By how much?		
How much premium is necessary to guarantee coverage at initial/current levels for the duration of the policy?		

	Present Policy	Proposed Policy
How will the premium payment mode (monthly, quarterly, semiannually, or annually) affect the policy if the premium is to be payable for a certain number of years?		
How many years will the premium need to be paid based on current assumptions?		
How many years will the premium need to be paid based on guaranteed assumptions?		
Cash/Surrender Value—Compare your current policy's projected cash values (based on current assumptions) with the new policy's first-year value. (Note: surrender charges may significantly—if not completely—reduce early values in any new policy.)		
Policy maturity/termination date:		
Is there a term rider on the policy? ☐ **Yes** ☐ **No** If yes:		
What is the ratio of the initial term amount to the total death benefit?		
Does the term rider convert to permanent insurance? ☐ **Yes** ☐ **No**		
If it does convert, when does it do so and is it guaranteed?		
Do the policies have any other riders? If so, list them to the right.		
What are the costs of these riders?		
How much are the setup/administration costs associated with the replacement policy?		

WHEN IT COMES TO REPLACEMENTS, DON'T FORGET ABOUT TAXES.

Caution: Please note that this is not tax advice and I am not a qualified tax adviser. Consult a qualified tax adviser for advice in your specific situation.

In many cases, you'll immediately recognize a financial gain when you surrender a life insurance contract, to the extent that the value of the policy received exceeds your adjusted basis (typically the sum of premiums paid) in the surrendered policy.

Section 1035 of the IRS code allows certain exchanges of life insurance to be made *without* the immediate recognition of gain. Section 1035 allows the tax that otherwise would be imposed on lump-sum disposition of certain life insurance policies (and annuities, incidentally) to be postponed. Here are the types of exchanges allowed through Section 1035 that would typically result in no gain (or loss) to be recognized:

An ordinary life insurance contract for another ordinary life insurance contract (one for which the face amount—that is, the death benefit—is not ordinarily payable in full during the insured's life)

An ordinary life insurance contract for an endowment contract (one that depends in part on the life expectancy of the insured, but that may be payable in full in a single payment during the insured's lifetime)

An ordinary life insurance contract for an annuity (one payable during the life of the annuitant only in installments)

An endowment contract for another endowment contract that provides for regular payments beginning at a date not later than the date that payments would have begun under the contract exchanged

An endowment contract for an annuity contract

An annuity contract for an annuity contract

Generally, a contract received in a 1035 exchange carries over elements of the original contract, in addition to basis. Please note that there are a number of Internal Revenue Service Private Letter Rulings, Revenue Rulings, and modifications. These are the basic rules, however, as previously stated; they may not apply in your specific situation. A qualified life insurance adviser will be able to point you in the right direction, even if that means consulting a tax attorney for expertise.

Don't worry if you're feeling a little overwhelmed here. Replacing a permanent policy isn't something to be taken lightly. But now that you've looked at both policies side by side, what's your gut feeling? Do you think the replacement is worth it? Does it provide the same value—or more—for less money? Explain.

Replacing a policy can oftentimes provide you with significantly more value than a current policy has. However, this is not always the case, and there can be negative outcomes. Please carefully review all the factors and the options. If you're not comfortable or don't fully understand a particular issue, it's better to not make the replacement, because *you can't go back*! Unlike in the game of golf, when the playing field is life insurance, no mulligans are awarded.

STEP 9

Terminating/Unwinding a Policy

In rare instances, you'll just want to **terminate (or unwind)** your policy. In other words, get rid of it entirely, with no intention of replacing it.

With a term policy, this is relatively simple, because there is no cash value tied up in the policy. You can cancel the policy either by not making the next scheduled premium payment or notifying the company and requesting immediate termination. In the latter scenario, most companies will issue a pro-rata refund of any unearned premiums, or—in plain English—a partial refund.

Permanent policies are more complex (as you surely understand by now), so this final chapter will focus on them. With permanent policies, you have options when it comes to termination: You can either (1) surrender the policy for its cash value, (2) exchange the policy through a Section 1035 exchange to an annuity, (3) gift the policy to a nonprofit or other entity, or (4) sell the policy in a secondary marketplace, known as a **viatical** or **life settlement**, if the policy is eligible. In this step, you'll learn what to look out for with each of these options.

Before you look at those four options, however, be sure you've asked and answered this question to your satisfaction: "Why do I want to terminate my permanent policy?"

Use the space below to first make it clear to yourself why you'd like to get rid of your policy. Is it that you no longer need coverage? Do you need the funds? Whatever the reason, use the space below to explain.

____

____

____

____

____

____

____

1 SURRENDER THE POLICY FOR ITS CASH VALUE.

Often omitted in original sales presentations is the possibility of a taxable gain if the policy is surrendered. The cash value in a life insurance policy generally accrues on a tax-deferred basis. This includes dividends, interest, etc. And, upon surrender, the gross value (including net cash surrender value, policy loans, or other value received during the life of the policy) is either income-tax exempt or partially income-tax exempt, depending upon how the policy terminates, the circumstances surrounding termination, and if the policy was held in a qualified retirement plan or owned by an employer or other third parties (please note that this does not cover all possibilities).

To determine the answer to this question, complete the following worksheet:

What is the net cash surrender value of your policy? $_____________

Is the sum of the net cash surrender value (and any policy loan and other value received)

☐ **smaller than** ☐ **equal to** or ☐ **larger than** the basis (which is usually the sum of total premiums paid)?

- If **smaller than**, then there is a "loss" on the surrender. That means that there is no gain on the policy. This "loss," however, is *not tax deductible*.
- If **equal to**, then there is neither "gain" nor "loss" on surrender. That means that there is no gain or loss on the policy and does not result in a taxable situation.

- If **larger than**, then there is a “gain” on surrender. That means this gain is generally considered ordinary income in the year you surrender the policy. According to Dr. Joseph Belth, the inside interest—which in this instance exceeds the price of the protection—is income-tax exempt to the extent of the price of the protection and taxable to the extent that the inside interest exceeds the price of the protection.

Now, if you answered **smaller than** or **equal to**, ask this follow-up question: Considering the personal needs and circumstances of both you and your beneficiary, is the immediate cash value you'll receive from the policy upon surrender really worth giving up your coverage?

☐ **Yes** ☐ **No**

If you answered **larger than**, ask this follow-up question: Considering the personal needs and circumstances of both you and your beneficiary, is the immediate cash value you'll receive from the policy upon surrender worth *both* the taxable gain and the loss of coverage?

☐ **Yes** ☐ **No**

2 EXCHANGE THE POLICY THROUGH A SECTION 1035 EXCHANGE TO AN ANNUITY.

If you have a need for a steady income stream and wish to defer taxes, consider using a 1035 tax-free exchange (allowing you to carry over your cost basis) to a single premium immediate annuity. Such a single premium immediate annuity can be obtained that would pay an annual income stream that would allow you to receive a guaranteed monthly income for the remainder of your lifetime. (Other payout options are available.) Each payout would be subject to taxation on an exclusion ratio basis. The percentage of the payout is calculated by the insurance company: A portion of each payout reflects a payout of basis (tax-free) and a portion is deemed interest, subject to ordinary income tax rates. As I mentioned previously, I am not a tax adviser and this is not qualified tax advice. You should *consult a qualified tax adviser* before making a decision to transact such an exchange.

3 GIFT THE POLICY TO A NONPROFIT OR OTHER ENTITY.

You might have an interest in donating your policy to a nonprofit organization. Donating a life insurance policy—especially one that requires no further premiums—can make a nice planned gift for a nonprofit. Generally, the policy will need to be unencumbered, which means there can be no outstanding policy loans against it. Although most nonprofits have planned giving officers who can walk you through the process, a number of such organizations will not accept a life insurance policy.

OTHER THINGS YOU SHOULD KNOW ABOUT LIFE SETTLEMENTS

The amount you receive will depend on a variety of factors: These include, among others, anticipated life expectancy (unfortunately, the shorter it is, the higher the pay out); the anticipated premiums the company will have to pay; if there are any loans outstanding against the policy; whether there is a premium waiver in case of disability; the insurance company's ratings; the prevailing interest rates in the economy overall; and the company's targeted rate of return. A life expectancy of 6 months or less typically brings about 80 percent of the policy's death benefit, although sometimes it can be as high as 85 percent. Conversely, a life expectancy of 60 months would bring 25 to 30 percent.

Also, keep these factors in mind:

If you have cash value in the policy, you can usually withdraw it.

It typically takes 4 to 8 weeks to sell a policy, although it can take longer, especially with some group policies. You can help speed things up by notifying your physician and insurance company to expect inquiries from the life settlement company.

The life settlement company will contact you after settlement to inquire about your health. You should check how a company you are considering usually handles this sensitive issue.

Life settlements are required by some states to have a period when the contract can be—canceled: for example, for a period of 30 days from the time it is signed, and 15 days after you receive the proceeds. Companies in states where there is no such regulation almost always offer a similar clause.

If you live past your anticipated life expectancy, there are no repercussions for you. That is part of the risk for the company.

4 SELL THE POLICY IN A SECONDARY MARKET.

Deciding whether to sell your policy is a personal choice that requires a level of comfort with the fact that if you do sell, your life insurance policy will be owned by a third party. The whole area of life settlements is vigorously debated, and it's important to understand the potential ramifications. A life settlement can provide you with greater value than your life insurance policy's net cash surrender value in certain circumstances, assuming that you and your policy are able to qualify.

A life settlement is the sale of a life insurance policy to a third party. Here's how it works: Essentially, you (the "settlor") sell your policy for a certain sum and the buyer becomes the new owner and/or beneficiary of the life insurance policy, pays all future premiums, and collects the entire death benefit when you pass away.

WHAT ARE THE CURRENT TAX CONSIDERATIONS FOR LIFE SETTLEMENTS?

When a life policy is sold, the tax treatment of life settlements generally leads to a two-tier taxation of the proceeds paid to the policy owner, where a portion may be taxed as ordinary income and a portion as long-term capital gain.

Keep these points in mind when considering a life settlement:

Recent guidance from the IRS (IRS Revenue Ruling 2009-13) indicates that in calculating basis, the portion of premiums allocable to the cost of insurance protection must also be subtracted.

Proceeds resulting from a life settlement are taxable only to the extent that the amount received exceeds basis (basis for life insurance typically is the sum of the premiums paid by the policy owner reduced by any amounts withdrawn).

To the extent that the amount received in the life settlement exceeds basis but is less than or equal to the cash surrender value of the policy, the monetary gain is taxed as ordinary income.

To the extent that the amount received in the life settlement exceeds the cash surrender value of the policy, the gain is generally treated as long-term capital gain.

At the insured's death, the life settlement investor normally owes income tax on the excess of the death benefit over the investor's investment in the contract.

If the life policy were retained rather than sold, the entire death benefit would pass income tax free to the insured's estate or named beneficiary.

Answer the following questions to the best of your ability to help you decide whether or not to sell your policy.

Basic Information

Typically, in order to qualify for a life settlement, your life expectancy must usually be 10 years or less. What is your current life expectancy? ______________ years

Is your policy beyond the contestability period? ☐ **Yes** ☐ **No**

Are there any clauses or waivers within your policy that would prevent it from being sold? ☐ **Yes** ☐ **No**

Does your life insurance company offer an accelerated death benefit (ADB) that will pay for all or some of your death benefit now? ☐ **Yes** ☐ **No**

If "Yes," talk with your insurance company. An ADB can help you get the cash you need without having to sell to a third party.

Selling the Policy

Do you have a personal financial or insurance adviser who can offer you assistance in the life settlement process? ☐ **Yes** ☐ **No**

If "Yes," which will he or she receive a commission on during transfer?

☐ **Death benefit** ☐ **Cash value**

How much will the commission be (percentage wise)? ____________%

How much is this in dollar terms? $ ____________

If you decide to approach a life settlement company directly, make sure you get offers from more than one and don't be afraid to negotiate. Do some research and list three life settlement companies here:

Company 1: ____

Is the company licensed to do business in your state? ☐ **Yes** ☐ **No**

Does the company comply with the National Association of Insurance Commissioners' Model Act and Regulations on viatical and life settlements? ☐ **Yes** ☐ **No**

Have there been any complaints filed on this company with your state's insurance department?

☐ **Yes** ☐ **No**

If the company requires that you sell at least a minimum percentage of your policy, what is that percentage? ________ %

Company 2: ____

Is the company licensed to do business in your state? ☐ **Yes** ☐ **No**

Does the company comply with the National Association of Insurance Commissioners' Model Act and Regulations on viatical and life settlements? ☐ **Yes** ☐ **No**

Have there been any complaints filed on this company with your state's insurance department?

☐ **Yes** ☐ **No**

If the company requires that you sell at least a minimum percentage of your policy, what is that percentage? ________ %

Company 3: ____

Is the company licensed to do business in your state? ☐ **Yes** ☐ **No**

Does the company comply with the National Association of Insurance Commissioners' Model Act and Regulations on viatical and life settlements? ☐ **Yes** ☐ **No**

Have there been any complaints filed on this company with your state's insurance department? ☐ **Yes** ☐ **No**

Is your policy's death benefit at least $250,000? ☐ **Yes** ☐ **No**

If the company requires that you sell at least a minimum percentage of your policy, what is that percentage? ________ %

Will the lump sum payout result in the loss of state and federal need-based aid such as Medicaid, food stamps, or Social Security income? (Check one, or consult with a professional.) ☐ **Yes** ☐ **No**

Do you owe a lot of money to hospitals, doctors, or other creditors? ☐ **Yes** ☐ **No**
If "Yes," know that they may seek payment from the proceeds you receive.

While it may be easy to make the decision to terminate a policy, it may not always be straightforward—as the foregoing text has shown. Hence my use of the term *unwinding* in the context of *terminating* a policy. It's best to know all of your options so you can maximize any value and minimize any potential tax impact.

CONCLUSION

While you shouldn't put off an important decision that would provide protection for your family, take the time to make sure you fully understand any policy you are considering. You should be comfortable with the company, agent, and product before purchasing anything.

Life insurance may be one of the most important purchases you (and/or your business) will ever make. As is the case with any important purchase, it pays to avoid the pitfalls into which you can so easily fall.

Life insurance is a very valuable component of financial planning. Life insurance is also a very complex financial instrument and needs to be treated as such. Every day, life insurance companies introduce new products and marketing concepts. As you've seen in this workbook, selecting and maintaining the "right" life insurance policy is a challenge.

The human mind seeks simple answers, but very often the simple answer is not the right answer. Proper selection of a life insurance product requires more than simply choosing the lowest priced policy. Many other factors must be considered in making an intelligent choice.

For most people, consulting a qualified and objective life insurance specialist is the best way to ensure that an appropriate recommendation is made in the circumstances.

The problem, from a consumer perspective, is making sure that the advice given is professionally objective. Many fine people make their living selling life insurance, but their living depends on making sales. This tends to affect their recommendations. For example, oftentimes an inexpensive term life insurance will do the job effectively for the least cost. Yet, even when term insurance will suffice, a great deal of permanent coverage is aggressively sold. The fact is that commissions on term insurance are much lower than on permanent coverage. Therefore, the incentive is there to sell permanent policies over term policies. Because of this reality in the industry, I decided to seek a life insurance analyst's license, as well as to write *Questions and Answers on Life Insurance* and this workbook.

Another reason why I've written this workbook is that oftentimes the life insurance salesperson does not service/review the life insurance coverage. As we've seen with the permanent (cash value) life insurance policies, this can lead to some unwanted results.

The tools in this book were therefore designed to assist you in understanding life insurance and monitoring your portfolio more easily. Please keep in mind that there is no substitute for the value that life insurance can bring into play for providing the discounted dollars and protection you need. Be sure the insurance agent gives you choices and options before you make a final decision.

After you have purchased an insurance policy, remember that you may have a "free-look" period—usually 10 to 30 days after you receive the policy—during which you can change your mind. Read your policy carefully during this time. If you decide not to keep it, the company will cancel the policy and provide an appropriate refund.

Review your policy periodically or when major life changes occur, such as purchasing a home or having children. An insurance agent can help you make sure your coverage is always aligned with your needs. Please see the last page of this book for information on keeping up to date through my website, blog, and newsletter.

The more informed you are, the better the choices you can make.

ABOUT THE AUTHOR

Tony Steuer, Chartered Life Underwriter (CLU), is a specially licensed Individual Life and Disability Insurance Analyst. There are about 30 such analysts licensed by the State of California. As an analyst, Tony has the knowledge, and the authority, to provide unbiased advice regarding life insurance. Tony also serves as a member of the Curriculum Board for the California Department of Insurance, the Lucille Packard Children's Hospital Foundation Advisory Board, and the St. Joseph's Elementary School Advisory Board.

Tony is the author of *Questions and Answers on Life Insurance*, a reference book covering the wide spectrum of life insurance topics in a format accessible to consumers and advisers, for which he won the Excellence in Financial Literacy Education Award from the Institute for Financial Literacy. The book was also listed in Nine Great Investment Books to Read by Forbes and was a Book of the Year Award finalist for Business and Economics in *ForeWord* magazine.

Tony also regularly writes for blogs and websites, such as NOLO.com, youandyourfamily.com, thenest.com, and for other publications. He was a technical editor for *The Retirement Bible* and *The Investing Bible*, both by Lynn O'Shaughnessy (IDG Books). He speaks at educational and professional meetings and conferences and he is regularly interviewed by the media—including *The Wall Street Journal*, slate.com, mint.com, bankrate.com, and *Newsday*—on topics related to insurance and investing.

Tony is a member of the California Department of Insurance Curriculum Board, Society of Financial Service Professionals Golden Gate Chapter, Financial Planning Association (FPA), Partnership for Philanthropic Planning, Northern California Planned Giving Council. He has also been on a number of boards and committees for various philanthropic organizations. Prior to commencing his own practice in 1995, Tony was an Assistant Vice President with Acordia-Lloyd, a multi-line insurance brokerage firm. Tony earned his Bachelor of Science in Finance degree from California State University at Chico.

RESOURCES

While I've tried to make this workbook fairly comprehensive, covering the concerns of the majority of people, some readers will have additional questions, needs, or points for follow up. And the life insurance industry and associated regulations change over time. I encourage you to use the resources on my website, www.lifeinsurancetoolbook.com, to resolve any issues or to ensure that you have the most up-to-date information. These resources can help you as you work through the steps of the life insurance Decision Chart.

From the main page of the website, within the Life Insurance Toolbox section, you can access helpful calculators, planning tools, and additional resources.

- **Calculators:** comprehensive life insurance analysis, the value of your future earnings (human life value), life expectancy, annual rate of return, and an annual percentage rate calculator that can help term life insurance policy holders save money every year on their premiums.
- Planning tools: descriptions of primary planning methods to help you deepen your understanding and your analysis, including human life value approach, capital preservation versus liquidation approaches, the life cycle model, and more.
- **Resources:** links to the rating services and NAIC Consumer Information Center, links to state insurance departments and FINRA, recommended readings, and other up-to-date information.

You can also find presentations on understanding term life insurance and permanent life insurance in the Slidecast section, blog articles on recent developments in the industry, and more.

WEBCASTS FOR ADVISORS, CONSUMERS AND ASSOCIATIONS, EMPLOYERS, AND SENIORS

Contact me for a free virtual presentation for your group!

- **For Advisors:** This presentation will give you the information and tools for effectively evaluating an existing or proposed policy and choosing a life insurance company. As an advisor, you will learn how to help clients avoid common pitfalls and provide the best guidance for their needs.

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- For Consumers and Associations: Consumers are bombarded with choices for life insurance and financial planning tools, and many are going to the Internet for information. Unfortunately, most websites in this field are powered by marketing experts, not financial experts. I empower consumers to make good decisions by engaging groups in a dialogue that relates to their needs and answering life insurance questions personally.
- For Employers: Employers offer all types of benefits to employees that are not always understood or appreciated. Through a custom webcast, Tony will review your company's group life insurance and long-term and short-term disability income insurance plans with your employees to help them understand the appropriate use and value of these benefits.
- **For Seniors:** Seniors are increasingly vulnerable to consumer fraud and scams. As an advocate for financial literacy, I focus on the need to protect seniors and arm them with information.

Bulk discounts on book orders are available for your group.

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Visit **www.lifeinsurancetoolbook.com** for updates, calculators, newsletter, resources, and much more.

A USER-FRIENDLY WORKBOOK

to MAKING EXPERT LIFE INSURANCE DECISIONS

Need help facing the constant barrage of information from competing life insurance companies? With twenty years of experience in the life insurance business, Tony Steuer delivers a practical, one-of-a-kind resource for choosing the best life insurance policy for you or your family, whether you currently have a policy or not. Step by step, he leads you through the process of making key life insurance decisions:

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2. What type of life insurance is right for me?
3. How might my medical and financial history affect my rates?
4. Which life insurance company should I work with?
5. How do I choose a trusted agent or advisor?
6. What policy components or riders are important to me?
7. Is my current policy living up to my expectations and needs?
8. Should I replace my current policy or supplement it?
9. What is the best way to terminate a policy?

A companion to Tony's award winning book, *Questions and Answers on Life Insurance*, this workbook will help you avoid unnecessary pitfalls and unpleasant surprises; make informed, confident decisions; and gain the maximum benefit for your life insurance dollar.

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