# It's Your Life

## *A Handy Guide To Understanding Life Insurance*

Developed by Colonial Penn Life Insurance Company

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## Introduction

# Face it…..

No one really likes to think about life insurance. But responsible people with a family to provide for – and assets to protect – cannot overlook its importance.

The problem is, life insurance is not a subject that is easy to understand. Indeed, it can be downright overwhelming. Given the different types of plans available, how do you know which one is *right* for you? How do you know how much life insurance you *need*? How do you know if the company that insures you is stable and *reliable*?

This guide contains information that can help you decide if you need life insurance, determine how much you should have, and explain why it's important you select the right company to protect your family. While this guide may not make you a life insurance expert, it will give you information to help you make a wise purchase decision.

# The Basics of Life

The key to understanding the purpose of life insurance comes down to a fundamental question: What would happen to your family – financially – if you were to die?

Unless you can honestly answer, "Oh, they'll be fine," you probably have some degree of <u>need</u> for life insurance. If your family was suddenly without income, they would need money from another source in order to get by – not just to pay bills and meet ongoing financial obligations, but to cover funeral costs and other final expenses as well. Thus, life insurance can be a valuable tool that can help protect your family in a number of ways.

*That's what we'll cover in this section. But first, a little history.....*

## "Life" in the past

The roots of insurance date back to more than 4,000 years ago. Prior to shipping their goods, Phoenician, Babylonian and Chinese traders would often pay an extra sum on loans to protect their cargo. This additional fee was called a "premium" – a term which, today, refers to the payment one makes to keep insurance in force.

Specifically, the practice of insuring human lives began in the early Roman Empire. Fraternal societies actually paid death benefits to the survivors of deceased members. In concept, this form of life insurance is very similar to the kind companies began selling in this country as early as the 18th century.

*Two basic types of life insurance companies emerged:*

*1. Stock company* – owned and controlled by stockholders, individuals or institutions that invest in the company's stock. Stockholders share in the profits and losses of the company.

*2. Mutual Company* – owned by its policyholders and managed by a Board of Directors. Profits are shared with the policyholders in the form of policy dividends.

The first stock life insurance company in America was called (believe it or not) The Corporation for Relief of Poor and Distressed Presbyterian Ministers and the Poor and Distressed Widows and Children of Presbyterian Ministers. The first mutual life insurance company was New England Mutual. Both still exist today.

Since the 1800s, the number of insurance companies in America has grown dramatically…and life insurance has become an integral aspect of basic family financial planning.

## "Life" as we know it today

In its contemporary form, life insurance has become more sophisticated, if not a bit more complex. There are many different types of life insurance today, but all of them are designed to fill the same fundamental need and serve an undeniably important purpose.

*What exactly is that purpose?*

Life insurance helps to ensure that your family and loved ones are protected against financial hardship in the event of your death. The money your dependents will receive is called the death benefit. It's an important resource that can be used to:

- pay off debts, such as the mortgage or credit card bills
- provide extra income to help pay ongoing household bills
- pay for your children's education
- pay funeral costs and other final expenses

Of course, your purpose for buying life insurance may be different than someone else's. So it's up to you to decide the type and amount of life insurance that is best suited to your specific needs. For instance, if your primary objective is to cover funeral costs and other final expenses, you may not need a plan with a high face amount.

For the purposes of estate planning, life insurance is a useful and flexible asset. It offers a practical solution for achieving a specific estate-planning goal. Traditionally, life insurance has been used to replace lost income. But ideally, it can be used for much more. Combined with investments and retirement planning, life insurance can be a fundamental part of a sound financial blueprint.

## "Life Stories"

The following fictional stories dramatically illustrate the ways in which life insurance can fill a vital need throughout various stages of life.

### Life Story #1:
### On Her Own

*Just out of school, starting her first real job, Amy loved having her independence. But she realized there were certain responsibilities that went with it…*

When Amy graduated from college, she didn't have any trouble getting a job or finding an apartment near by. The apartment gave her a feeling of independence, and the job paid her a pretty good wage…even if it was a little short on benefits.

Her employer provided decent medical coverage, but no life insurance. At first Amy didn't care. "Who needs life insurance at 22?" she reasoned. But, the more she thought about it, the more she realized that she needed it. Her parents were retired and living on a fixed income. An important part of the independence Amy enjoyed was knowing she was no longer a financial burden on her folks. She knew that being truly independent also meant making sure she wouldn't leave any expenses behind if – as unlikely as it seemed – anything happened to her.

She found, to her pleasant surprise, that at her age she could purchase a Term Life Plan with a modest face amount that would give her the protection she wanted for just a few dollars a month. Best of all, it made her feel even more independent.

### Life Story #2:
### In a Family Way

*Scott and Lucy were happily married with a baby on the way. But they were about to lose one income, and the life insurance coverage her job provided…just when they needed it most…*

When Scott and Lucy Miller decided to start their family, it was easy to see that it would be more economical for Lucy to stay home than to put the baby in daycare. They worked out a comprehensive budget that would let them get by on just Scott's salary.

But one thing they failed to consider until months later was that, along with losing Lucy's salary, they would also lose her employer-provided life insurance. Scott's company provides him with a Term Life policy worth twice his annual salary – not nearly the amount Scott felt they needed.

Furthermore, Lucy <u>had</u> to have life insurance. If anything happened to her, Scott would have to hire someone to help with child care and more.

A supplemental Term Life Plan proved to be the perfect answer – providing additional coverage for Scott, and an equal amount for Lucy. It gave them just the coverage they needed and was affordable enough to leave them room in their budget for savings…like a college fund.

## Life Story #3:
## The Eye-Opening Tragedy

*Buy it, then forget about it. That was Gail and David's philosophy on life insurance. But then something happened that made them think twice…*

Through 20 years of marriage, Gail and David Keene hadn't really given much thought to life insurance. They had purchased a policy soon after they were married and figured that was that. The policy was promptly filed away with their other important documents – out of sight and out of mind.

But recently, the subject of life insurance came back into their lives in a heart-wrenching way. David's younger brother, Edward was killed in a car accident at the age of 45. Losing a loved one so young was devastating enough. But to make matters worse, Edward's death caused financial hardship for his wife and family. His only life insurance was a policy he had bought many years ago – prior to three job changes and the purchase of a dream home. It was no longer sufficient for his family's current lifestyle. His wife had to sell their home and find a higher-paying job to make ends meet and save a little money for their twins' education.

Gail and David didn't want to ever be in the same situation. They took a look at their old policy and determined that its benefit amount was no longer adequate. To supplement their coverage, they purchased a whole life plan – enough to bring their coverage up to today's standards – with the flexibility to borrow against if need be. They were determined that history would not repeat itself.

## Life Story #4
## One Less Worry

*After 48 years of marriage, Betty became a widow at 70. Before her husband passed away, however, he did something that proved how much he cared about her…*

Betty was always a bit of a worrier. When her children were young, she worried about them not dressing warmly enough…or not eating right…or getting sick. Today, as a grandmother, she hasn't changed a bit.

"I can't help it," she once said. "I just worry." It's an endearing trait that Roland, her late husband, had come to cherish. He knew it was a reflection of her goodness and compassion.

But there was one thing that Roland did not want Betty to ever worry about – money. He didn't want Betty to be burdened with debt if she were to suddenly be without him. So, shortly before retiring from his post office job, Roland bought a small whole life insurance policy to cover the cost of his final expenses.

When Roland passed away at age 73, the money from his policy was more than enough to pay for a casket, the cost of the funeral, and a few outstanding medical bills. Betty even had a little left to arrange for some life insurance of her own – to make sure that she won't be a burden to her children.

After all, she was always a bit of a worrier.

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These stories illustrate the flexibility of life insurance – and how it fulfills different purposes at various life stages. The point is, everyone has their own "story" – their own unique reason to buy life insurance. Now let's take a look at the matter of purchasing the right plan for <u>your</u> family.

# Buying Life Insurance

## What kind should you buy?

Given the choices you're faced with, this can be a challenging question. The answer lies in having a clear picture of how you want your coverage to fit into your overall financial plan…and how much you can afford to pay.

Here's a brief overview of two common types of life insurance available today.

## Term Insurance

As its name implies, term life covers you for a limited term. You can use it until you've reached a certain life stage. For example, the length of time you want your coverage to be in force might be until your children are grown, or until college is paid for, or until you retire.

With term insurance, you pay premiums on a regular basis for as long as your coverage is in effect. Generally, the premiums increase with age, or the premium may stay the same but the benefit will decrease. If no claim is made against the policy during the term, neither you or your beneficiary will receive any benefits after the policy is no longer in effect.

There are various types of term life insurance. One such variation is "Renewable Term," which automatically renews your coverage at the end of a certain period of time. For instance, with a 5-Year Renewable Term plan, your coverage can be renewed every fifth year until the expiration date – even if your health changes.

Another common type of term insurance is "Decreasing Term Life," which provides a sound way to add to existing coverage if your need for coverage will decrease over time. As a means of keeping premiums affordable, the face amount gradually decreases over the years.

In essence, term life is "pure" protection – with no added features that increase the cost. Generally, premiums are lower than for whole life insurance – particularly at younger ages. For this reason, term insurance is often a better choice for young families with large financial obligations.

You may have heard the phrase, "Buy term, invest the difference." The logic behind that is this: the substantially lower premiums enable you to purchase a greater amount of coverage, while the money you save on premiums can be

placed in other investments (mutual funds, money market accounts, etc.) that could generate returns similar to or better than life insurance contracts.

### Whole Life Insurance

*(also called permanent insurance or cash value insurance)*

Whole life insurance provides coverage similar to term insurance, with two key differences. First of all, it's permanent and does not expire at the end of a specified term (assuming you continue to pay premiums). In other words, it stays in effect your "whole" life. Or, in some cases, the insurer will return the face value of your policy to you once you've reached a pre-determined age. Usually the premium is based on your age when the policy takes effect and stays the same for life.

The second basic way that whole life differs from term life is its cash value feature. Part of your premium goes toward insuring your life while the rest of it is invested. The invested portion earns interest – which is how your policy "builds" cash value. Here are some of the advantages of the cash value feature:

- If you cancel your policy, you can receive the cash value amount as a lump sum payment. (Keep in mind, though, that it is unwise to surrender your policy in the first few years because it will have accumulated little or no cash value).
- If, for some reason, you must stop paying your premiums, the accumulated cash value can pay them for you – for a specified time – thereby keeping your coverage in force. Or your cash value may be used to provide a smaller amount of coverage for the rest of your life.
- Using the cash value in your life insurance as collateral, you can borrow money from the insurance company. The loan is not subject to credit checks or other restrictions as it would be with most financial institutions.

The cash value of a whole life insurance policy is not the same as its face benefit amount. There is an important distinction: the cash value is the amount available if you cancel a policy before its maturity, while the face amount is the money that will be paid at death or when the policy matures.

The money paid out by a whole life policy is not subject to federal income tax, according to current IRS rules, or the laws of probate. For this reason, many people find whole life insurance to be an important tool for tax and estate planning purposes.

## Annuities

While not life insurance, an annuity is essentially a contract which guarantees an income will be paid for a period of time – even for life. When you purchase an annuity, you decide how much to contribute and how often. You may choose to pay a single premium or make periodic payments. Once you've begun paying premiums, the money you invest grows tax-deferred.

There are two types of annuities: *fixed* and *variable*. With a fixed annuity, the insurance company is responsible for where your money will be invested. With a variable annuity, you assume responsibility for investment decisions. A typical annuity contract includes three parties:

- The *annuitant* – the person on whose life the terms of the annuity are measured and to whom the income is paid.
- The *annuity owner* – the person who has the rights to the contract, such as the right to name a beneficiary, and the right to assign the contract. The annuitant and the annuity owner can be the same person, but do not have to be. For instance, a wife can own a contract with her husband as the annuitant.
- The *beneficiary* – the person who will receive payment upon the death of the annuitant.

The annuitant may choose to have income payments made in one of two ways: *immediate or deferred*. The immediate annuity requires a "single premium" up front and begins paying right away – usually a month after the premium is deposited. A deferred annuity accumulates principal and interest for payment at a designated future date. With this type of annuity, you may choose a "periodic payment" option, in which you make regular contributions.

Without careful planning, many people of retirement age face the possibility of running out of money during the remainder of their lifetime. That's why annuities – with an option of income for life – have become so popular.

## How much should you buy?

This is, perhaps, the trickiest aspect of the life insurance purchase. As stated earlier, everyone who's responsible for the financial well being of others may need life insurance. But within that vast group of people, specific needs vary greatly.

Obviously, you want enough coverage to meet your specific needs. Your objective is to help alleviate the financial hardship your family could suffer with the loss of a breadwinner. Achieving this could range in scope from providing money to pay final expenses and other immediate costs…to ensuring that your dependents will have the income they need to maintain their current lifestyle. On the other hand, it's not a financially sound decision to buy more life insurance than you need.

*So how do you determine your specific life insurance needs?*

Over the years, a pretty good rule of thumb has been established. Some advisors suggest that the total face amount of your life insurance coverage equal **five to seven times your annual gross income**. This is a reliable guide to follow if your purpose for buying life insurance is to maintain your family's lifestyle.

This rule does not apply, however, if your life insurance objective is to cover funeral costs and other final expenses. You should merely purchase the amount of protection necessary to do so. (The worksheet on the following page can help you calculate anticipated final expenses.)

For a more detailed and customized assessment, you should consider all of your ongoing monthly financial obligations – including mortgage or rent, utility bills and so forth. Then factor in anticipated future needs, such as education costs and retirement planning. And don't forget about final expenses – including funeral costs and outstanding medical bills. Chances are you'll discover that the amount of life insurance you need to keep your family adequately protected is greater than you realized.

In effect, what you have to determine is how much money your family will need at the time of your death. This is a combination of two factors:

1. *How much will be needed to meet immediate obligations; and*

2. *How much future income is needed to sustain the household.*

With the help of a calculator, use the following worksheet to estimate how much would be needed to cover final expenses.

## CALCULATING YOUR FINAL EXPENSES

*TYPICAL EXPENSES*

| | YOUR NEEDS |
|---|---|
| **Funeral Costs**: The average cost of a traditional funeral is almost $6,130 according to the most recent survey by the National Funeral Directors Association. | ______________ |
| **Outstanding Debts**: How much cash is needed to pay any credit card or loan balances? Consider, too, you could leave hundreds – even thousands – of dollars in unpaid medical expenses. | ______________ |
| **Living Expenses**: Would your family need cash to keep your household going until Social Security or other benefits kicked in? If so, make sure you leave enough money to cover a few mortgage payments and utility bills. | ______________ |
| **Gifts**: List any contributions you would like To make to a favorite charity…and any cash You'd like a special relative or friend to inherit. | ______________ |
| **Other**: | ______________ |
| **TOTAL OF YOUR NEEDS** | ______________ |

### From whom should you buy it?

It's been said that a life insurance policy is only as good as the company behind it. And fortunately, it's not difficult to determine which companies you can turn to with confidence.

Insurance companies are examined and their financial strength is rated by several independent agencies – and the rating are readily available. Before purchasing a life insurance policy from any insurer, it is wise to find out how that company is rated. Three leading rating services are A.M. Best, Standard & Poor's, and Moody's.

**A.M. Best** evaluates an insurance company's ability to meet its obligations to policyholders. Based on that evaluation, Best assigns the company a rating, which will fall into one of two broad categories – Secure of Vulnerable. "Secure" ratings range from A++ (Superior) to B+ (Very Good). Companies rated B or lower are considered "Vulnerable".

**Standard & Poor's** ratings reflect the agency's current opinion of an insurance company's financial security. This opinion takes into consideration the company's ability to pay on its policies. Standard & Poor's highest rating is 'AAA,' which indicates that a company has EXTREMELY STRONG financial security characteristics.

**Moody's** Insurance Financial Strength Ratings indicate a company's ability to pay claims and meet obligations. Moody's assigns symbols that designate where a company falls in a range from greatest financial strength to least financial strength. Highest rated companies are awarded a rating of Aaa.

For more information about insurance company ratings, you may contact the agencies directly:

A.M. Best Company
www.ambest.com

Standard & Poor's Rating Group
www.standardandpoors.com

Moody's Investor Service
www.moodys.com

## Making a Life Insurance Claim

*To receive the proceeds of a life insurance policy, the beneficiary must file a claim. Here are some tips on how to make that process easier:*

- Store your policy in a safe place where your beneficiary will be able to find it. When it comes time to make a claim, your beneficiary will find it helpful to have the policy close at hand for reference.

- Make sure your beneficiary has the name of your insurance company so that he or she knows whom to contact when making a claim. The insurance company will provide the necessary claim forms, assist your beneficiary with completing them, and answer any questions.

- Your beneficiary may be asked to secure certified copies of the death certificate from the funeral director to be submitted with the life insurance policy claim. A copy of the policy itself may also be requested.

- Once the claim is submitted, the benefit is usually paid in fairly short order. Payment may be made in a lump sum or installments, according to the instructions provided by you or your beneficiary.

Always keep in mind that life insurance companies have claims departments with trained representatives who can offer assistance throughout the claims filing process.

## Glossary of Insurance Terms

**Accelerated Death Benefits (ADB's)** – Benefits available prior to the insured's death, available in some life insurance policies. These benefits are usually available only due to terminal or catastrophic illness, or for long-term care or confinement to a nursing home.

**Accidental Death Benefit** – Sometimes referred to as "double indemnity," this is a policy add-on that provides for the payment of an additional benefit in the event of death due to an accident.

**Automatic Premium Loan** – A provision in some life insurance policies designed to provide policyholders with added flexibility by automatically "borrowing" from a policy's cash value (if sufficient) to keep the policy in force even if the premium due has not been received by the end of the grace period.

**Beneficiary** – The person(s) or entity(ies) named in the policy as the recipient of insurance proceeds upon the death of the insured. The term "beneficiary" also applies to those person(s) who are designated to receive the income from, or assets of, a decedent's estate or who are named to receive income from, or the assets of, a trust.

**Cash (Surrender) Value** – The money available to the policyholder in cash upon surrender of the policy.

**Dividends** – Money returned to participating policyholders. Dividends reflect the difference between guaranteed and actual expenses and mortality costs, and investment yields.

**Estate** – The total value of a decedent's assets at the time of death. Such assets may be passed directly to a beneficiary via a will, or held in trust for the beneficiary.

**Evidence of Insurability** - The presentation to a prospective insurer of an applicant's current and historical medical status. Usually this is a disclosure of health history via a questionnaire (although other evidence may be requested) to an insurer so that it may determine the appropriate premium to charge for the risk the insurer expects to accept.

**Face Amount** – The amount stated on the face page of the policy that will be paid upon death or maturity. The face amount of **certain types of** permanent policies can increase by the amount of cash value in universal life policies, or by the amount of paid-up additions in whole life policies. Accidental death benefits, if any, are payable in addition to the face amount. Other special provisions may affect the face amount.

**Grace Period** – A designated period of time following each premium due date in which an overdue premium may be paid without loss of coverage.

**Guardian** – A person or persons named to care for minor children until they reach the age of majority. A will is the best way to ensure that the person or persons whom you wish to have care for your minor children are legally empowered to do so in the event of your death.

**In-Force** – "In-force" policies are those which are currently valid and include all the elements of a valid contract.

**Insurability** – An assessment of the applicant/insured's health status used in determining the appropriate premium that is commensurate with the risk assumed by the insurer. There are three basic categories of insurability: *preferred*, *standard*, and *rated*. Preferred applicants are those whose health is above-average. Standard applicants are of normal health status. Rated applicants are those whose health is below average, e.g. those who have had a form of cancer, or a heart attack, etc.

**Insured** – The person whose life is covered by a policy of insurance.

**Lapsed Policy** – A policy which has been terminated and is no longer in force due to non-payment of the premium due. (See Non-Forfeiture Values)

**Maturity** – The date upon which the face amount a life insurance policy is paid to the policyholder (if not previously invoked due to the death of the insured).

**Non-Forfeiture Values** – The value of a policy if cancelled, either in cash or in another form of insurance. Such values are sometimes also available even if a policy, though not cancelled by the insured, would otherwise lapse due to non-payment of premium.

**Policy** – The actual terms of a contract of life insurance. A printed copy of these terms is provided to all policyholders. However, even if the policyholder's printed copy of the contract is lost or misplaced, the contract itself remains in force as long as the premium due is paid in a timely manner.

**Policy Loan –** The amount of the policy's cash value that has been or can be borrowed by the policyholder. The amount of any money borrowed by a policyholder and not repaid prior to death is deducted from the face amount that would otherwise be paid to the policy's beneficiary(ies).

**Premium –** The regular periodic payment a policyholder makes to an insurance company to keep an insurance policy in effect.

**Probate** – The process of legal certification of a decedent's written instructions as to the disposition of his or her estate.

**Reinstatement** – The restoration of a lapsed policy to in-force status. The company may require evidence of insurability (and, if health status has changed, may deny reinstatement), and will always require payment of the total amount of past due premium.

**Rider** – An amendment to an insurance policy that generally expands – or modifies – the policy's benefits. Expanded coverage riders may be added at the insured's request, upon payment of the extra premium.

**Surrender** – The cancellation of an in-force policy by the policyowner. The policyowner receives the full cash/non-forfeiture value and the insurer is no longer obligated to pay the death benefit.

**Trust** – A trust is a legal entity established by one person for the benefit of other persons. The person establishing the trust is usually called the "grantor." Those receiving income from, or the assets of, a trust are called "beneficiaries." The assets of a trust are managed or overseen by a "trustee" – whose responsibility is to act only in the interests of the beneficiaries.

**Underwriting** – The process of grouping applicants for insurance by characteristics such as age, gender, health occupation, and lifestyle or hobbies. People with similar characteristics are assigned a similar level of risk – and premium amounts are determined accordingly.

## For More Information …

Visit www.acli.org

*Or check the following publications:*

The Complete Idiot's Guide to Buying Insurance and Annuities
*By Brian H. Breuel*

The New Life Insurance Investment Advisor
*By Ben G. Baldwin*

Financial Planning for the Utterly Confused
*By Joel Lerner*

This "***It's Your Life, A Handy Guide to Understanding Life Insurance***" booklet was prepared by Colonial Penn Life Insurance Company to provide general information about types of life insurance that are available, provide tips on what to consider when selecting a policy and to assist you in evaluation your need for life insurance. This booklet is not an insurance contract and does not become part of any insurance policy you have or may purchase.