Financial Planning: Personal Insurance Needs

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By: CPA Magazine

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Need for Life Insurance

By: Walter G. Austin, Ph.D., CPA

There are three basic decisions to be made when discussing life insurance. First, do you need any insurance; second, what is the amount of insurance needed; and third, the kind of insurance to buy.

Your investment portfolio's impact on the amount of life insurance needed is discussed and the probable portfolio of the beneficiary's impact on the amount. The naming of a beneficiary to your life insurance is covered.

Do You Need Life Insurance?

Do you need any insurance at all? That is the first thing that should be considered. Is anyone depending on you for his or her needs and desires? Maybe you have no dependents. If not, what is the purpose of having the insurance? Possibly you have adequate money and investments to take care of all personal concerns at death and don't need an additional instant estate for someone.

If you are single and any children are grown, do you have a need for life insurance? If your investments will take care of your funeral expenses, then the question really is: do you want to leave a larger estate than you would have otherwise? Or, if you are in your 70s or older, should you spend good money on insurance premiums, money you might need now, to pay for your funeral or an estate for someone? Only you can decide.

Let's say that you are young and have no dependents. Just because insurance rates rise as you get older is no reason to buy something you don't need. There isn't much of a difference between premiums for a 25-year-old and those for a 35-year-old. The rates do not rise significantly until you are in your 40s. However, if you have knowledge of all the factors, you may want to purchase a permanent plan in order to take advantage of the long-term earnings inside the policy.

One phenomenon of the current generation: both parents working, and believing the notion that if one dies the other will be able to take care of the children (they assume each of them could be self-sustaining). Most people would say that they don't need insurance. But is this true? On the surface, no insurance makes a lot of sense, since people can theoretically save the premium money and invest it. However, have you ever heard of both parents being killed in the same accident? Certainly you have. In this case, you may want to use term insurance on one of the parents, or a Second-to-Die policy, which pays on the last of the two parents to die, thus protecting the children. It becomes a case of: which is the cheapest? Term insurance on one parent, or a Second-to-Die policy on both parents?

Investments and the Need for Life Insurance

The size of your investment portfolio can greatly impact your need for life insurance (that takes care of normal life insurance needs) and for insurance dealing with estate planning concerns. Assuming you were broke, you might feel you needed $1 million of life insurance, after a careful analysis. If it was the case, however, that you had a $2 million diversified investment portfolio, you would not have a need for normal life insurance—unless you desired to instantly build a larger estate for your heirs.

On the other hand, with the above illustration you might need some life insurance in your estate planning to provide liquidity to pay estate taxes. Even with the $2 million portfolio, a decision to be made is: Do you buy more insurance or invest the money that would have been the premiums? There are no simple solutions to these questions. Careful analysis should always be made in conjunction with your professional financial advisor(s).

Beneficiary Designations

The right to name a beneficiary or beneficiaries rests with the policyholder. The insured usually is the owner of the policy, but there are many policies outstanding today that have been applied for, and are owned by, someone other than the insured. Or it may be that ownership has been transferred by the insured to another after the policy was in force. The insured generally reserves the right to designate and change the beneficiary, and the rule prevailing in most states is that the insured can exercise the rights under a policy without a revocable beneficiary's consent.
Consider this beneficiary designation: "Sue Smith, wife of the insured, if living at the death of the insured, otherwise to such of the lawful children of the insured as may be living at the death of the insured." Here Sue Smith is the primary beneficiary and the children are contingent beneficiaries. Also, second contingent beneficiaries may be designated in the event none of the primary or contingent beneficiaries survive the insured. It is considered good practice to designate more than one beneficiary.
Probably the most commonly used designation is one that names the insured's wife or husband as primary beneficiary, with the children as contingent beneficiaries. It is customary to describe the beneficiary by his or her family relationship to the insured, or as a "friend or business associate" and the like.

Amount of Insurance Needed

Think of the future. If you just started working, your present income is probably relatively low. You may have recently graduated from a University and have begun a new job at just $50,000 a year. Five years from now, however, you might be making $85,000. You should not base your life insurance needs solely on what your earning power is today.

If you have children, you must ensure that they will be taken care of until they are on their own. That often means that your will want to provide for their college education. You are not sure what it will cost to educate someone 15 years from now? We do know that four years of college can cost more than $200,000 now.

Thus, the amount of life insurance you need depends on several things. A major item to consider is the replacement of your earning power needed to support your dependents for as long as you would have done so otherwise. This may be spouse, children, parents, aunt, uncle or another person who is dear to you and needs your help. The issue is how much will your survivors need if your income suddenly ends because of death? Don't rely on a rule of thumb or take an arbitrary amount as most people tend to do. Determine the needs of the beneficiaries. Include in those calculations the normal increases in salary you would have received in addition to inflation adjustments on the income needed for the beneficiaries.

Other items to be considered include market value of current investments and special needs of the beneficiaries such as:

• Final lump-sum expenses (last medical and burial expenses, probate costs, and other legal expenses);
• Costs of college education of children;
• Ability of your survivors to earn the standard of living desired for them by you;
• Any unusual lump-sum payment that can be foreseen;
• Potential life span of beneficiaries;
• Incapacity of a beneficiary; and
• Any other specific need that would have been provided for by you.

Discount all the future needs as analyzed above. The discount rate should be a conservative earnings rate on the proceeds as discussed in the following section.

Importance of Portfolio of Beneficiaries

One item that is not normally discussed when determining the variables in the calculations for the amount of life insurance needed is the investment vehicle to be used by your beneficiary. This is as important as any other item used in the calculation of the amount of insurance needed. If the proceeds are going to be invested in Certificates of Deposit, the amount of insurance necessary to provide the needs desired is close to or more than double the amount needed if the proceeds are to be invested in a good allocation of growth and income mutual funds.

Example: Let us assume that you are a 30-year-old wage earner with two children (presently ages 2 and 4) and you need to provide the family with $25,000 a year in addition to their social security benefits, and with one-half of the college expenses in a public university. Let's also assume that you, as the wage earner, have not accumulated any savings at this point, but also do not have any debt other than on automobiles. Related assumptions made include inflation at 3%, a CD rate of 5%, $10,000 needed for burial and medical expenses left over, and the surviving spouse living to be eighty. To cover this situation, the amount of insurance needed will range from $375,000 to $850,000 depending on the investment vehicle used by the beneficiary.

• The beneficiary that is very conservative and wants all investments in guaranteed short-term vehicles will need approximately $850,000 to cover the above situation.
• If the beneficiary is conservative, but will allow a balanced combination of stocks and bonds, the amount necessary will only be approximately $460,000.
• If a portfolio of growth and income mutual funds is used, the amount of insurance needed to cover the situation will only be approximately $375,000.

Another example uses the same information and assumptions included above for you as a 45-year-old wage earner, with children ages 16 and 18, and having $75,000 in investments and $60,000 in income to be replaced.

• The amount of $675,000 in insurance is needed if the proceeds are invested in stock mutual funds.

• An approximate amount of $900,000 is needed if invested in balanced mutual funds.
• An approximate amount of $1,500,000 of insurance is needed if the proceeds are going to be invested in Certificates of Deposit.

It is quite notable how significant the insurance differences required are based on the investment vehicle chosen by the beneficiaries.

Types of life Insurance Overview

There are many kinds of insurance policies. They range from annual renewable term to Second-to-Die variable universal life policies. In spite of the many different faces and names of policies, there are just two basic kinds of life insurance, pure life insurance and life insurance with savings.

The advantages and disadvantages of term insurance and when to buy term insurance are discussed. Also discussed are the various categories of permanent whole life insurance. The characteristics of universal life are covered. Variable life as insurance, and as an investment vehicle, is discussed. Caution is advised about depending on projections with a high investment earnings rate, and about borrowing a policy loan on variable life insurance.

Term Insurance

There are two main kinds of term insurance, level benefit term and decreasing benefits term. Level term insurance provides an amount of insurance that stays the same over the life of the policy.

Decreasing term insurance provides an amount of insurance that decreases over the life of the policy. It is suited to those situations in which the need for protection decreases over time. Probably the best example of the usefulness for decreasing term would be in paying off a home mortgage. The mortgage decreases over time – thus less life insurance coverage is needed as time passes.

Term insurance provides a straight death benefit. You pay the insurance company in the form of premiums, and the insurance company pays money to the beneficiary if you die during the term of the policy. Term insurance thus is comparable to most forms of property and liability insurance. Term policies generally have no cash or loan values. Since term insurance provides "pure" protection without also building up a cash value, it has a relatively lower premium.

With level term insurance, the premium increases when a new policy is obtained and the insured gets older. If the insured does not renew after the term ends, then dies later, the insurance company owes nothing to anyone. They have carried out their responsibility and that is to cover the risk of your dying while your policy was in force.

Term insurance policies range from the annual renewable (renewed each year at usually higher premiums) to 30 year level term (same premiums for 30 years with the policy guaranteed for that 30 years as long as the premium is paid). The concept of the annual renewable term insurance is simple: all you pay for is the insurance coverage. When the term policy is expanded from a one-year policy to a five-or-more-year policy, the insurance company is just averaging the premiums for all of those years.

When to Buy Term

You should consider buying term insurance if ALL of the following factors exist:

• First, if the family has a long-life history without major health problems
• Secondly, if you have the discipline to buy term insurance and invest the difference
• Last, if you already have enough investments that will, by conservative measurements, grow large enough by the end of the term insurance period that they will negate the need for life insurance altogether.

If your family history or known personal history indicates the likelihood that you will not be insurable or that the cost of insuring will be prohibitive when the term policy expires, then term is not a good option. Or, if you do not have the discipline to save and invest the difference between the cost of the term policy and the policy with a savings feature, then strong consideration should be given to the purchase of a permanent insurance policy that has a savings feature in it.

One view of some professionals is that a client should always have some permanent insurance. This area of thought brings out the point that you do not know whether there will be anyone needing your financial resources twenty, thirty, forty, or more years in the future. Might a spouse, child, or close relative of yours who would have depended on you become an invalid needing special care? He or she would then need help that the resources you planned on having available couldn't provide.

These professionals also have the opinion that you never know when you will have an accident and become uninsurable, even though your family history is long-lived. Also, there is not any assurance that you will be successful in saving or investing, or that your investment returns will be what you anticipate. In other words, no one knows the future and you should plan accordingly. Everyone knows the perfectly healthy-looking person who has had a heart attack in his or her thirties.

Permanent Insurance - Whole Life

Permanent insurance has one common characteristic: as long as you pay the premium, you have insurance. The amount of the insurance and the premium you pay may vary with different policies, but you will have insurance as long as you pay the premium or have the cash value in the policy itself to pay the premiums for you. There are various kinds of permanent insurance policies as seen below.

Whole life insurance furnishes protection for the whole of life. Premiums may be paid throughout the insured's lifetime or over a limited period of time. Premiums also may be paid in one lump sum at the creation of the policy, in which case the policy is referred to as a single-premium whole life policy. When the premiums are paid throughout the insured's lifetime, the policy is commonly referred to as "ordinary (or straight) life insurance." When the insured is to pay premiums over a limited period, such as for 25 years or to age 60, it is referred to as "limited payment life insurance."

Categories of Whole Life

Whole life policies fall into two different categories: those that have a guaranteed premium for life, and interest sensitive policies where the cash values and premiums will vary according to the rise and fall of interest rates on the insurance company's investments. When interest rates rise, the cash value will rise due to the increase in earnings on investments. This would lower the premiums or reduce the number of payments required to take care of the policy for life.

When interest rates decline, the cash value will decrease due to the decrease in earnings on investments. This would raise the premiums or increase the number of payments required to take care of the policy for life.

When determining fixed premiums on whole life policies, insurance companies must look at historical interest rates and protect their financial position by using the lower interest rates. With the fixed premium policies, the amount of the policy, the premium, and the cash value are all guaranteed for life. This is the only policy in which all three are guaranteed for life. Term insurance guarantees a premium and the amount of policy for a specific time only. There is no cash value. Universal Life and Variable Life have no guarantees other than if you pay the life insurance premiums you have some insurance.

There are situations where there is a strong preference for a fixed premium with no chance of it changing. Your budget is known and the premium fits in your budget, and no changes are welcome. A good example of this might be when a whole life policy is purchased within a trust to take care of Estate Taxes. The money is present within the trust and you do not want to have to contribute more.

On the other hand, fixed whole life premiums are usually higher than the premiums of interest sensitive policies. You may desire to share in the increases in earnings on the investments of the insurance company, rather than letting the company keep them.

Whole life insurance devotes part of your premium to the death benefit and part to investments. The policy builds up a cash value based on those investments. When the proceeds from the investments are high, whole life insurance can at certain points generate enough income to pay the premiums in later years. It's this provision of life insurance that agents make so appealing.

Universal Life Insurance

Universal life is a flexible premium life insurance policy, which separates the "pure" insurance protection of a permanent life insurance policy from the investment element in the policy. Universal life is, then, term insurance with a cash accumulation fund inside the policy. The excess of the premium over the cost of insurance in the early years is set up as a cash value fund to which is credited investment income on the fund.

As with interest-sensitive whole life, when interest rates rise, the cash value will rise due to the increase in earnings on investments. This would either lower the premiums, reduce the number of payments required to take care of the policy for life, or increase the amount of life insurance. The opposite occurs when interest rates decrease.

Under universal life, you may vary the premium. You can also take out policy loans against the cash value. Normally, there is a minimum guaranteed rate of interest with the current interest rate applied to the cash value each year unless it is less than the guaranteed.

There are two types of death benefit available under universal life policies. One type has a level death benefit. Under the second type, the death benefit is equal to a base amount plus the policy's current cash value. The increasing benefit policy characteristic causes some to view this policy as an investment tool. There is considerable debate as to whether it truly is an investment. This will be discussed in the investment section.

A universal life policy has very few guarantees. The premium is not guaranteed and the mortality costs are not guaranteed. There is a minimum guaranteed rate, which is usually around 4%, and usually there is a current guaranteed rate, which is in existence for one quarter to one year, depending on the policy. In fact, the premium, the insurance amount, and the cash value may vary.

Variable Life Insurance

Technically, Variable Life Insurance is Variable Universal Life Insurance, since it is a universal life product with variable investment options. The shorter version of the term will be use for the sake of brevity.

In an era of awareness concerning the large difference over time between investing in bonds versus stocks, many clients who desire permanent insurance and are attuned to the stock market have opted for the advantages of variable life insurance. Insurance companies invest in bonds for the cash value of Whole Life and Universal Life policies. Variable Life adds a new dimension in the progression from term to Universal Life. Interest Sensitive Whole Life and Universal Life added the dimension of variability within interest bearing investments (bonds) that are credited to the benefit or loss of the insured rather than to the insurance company. The insurance company charges their operating costs, profit margin, and the costs of insurance against the investment earnings, with the difference going to the insured.

Variable life adds the dimension of being able to invest in the various kinds of stocks within the policy in the same way as investing outside of the insurance policy when buying term and investing the difference in stocks or mutual funds. Most variable life products now have the option of utilizing some of the same managers that an investor in mutual funds would have. You, as the insured, will not have the same option of taking the funds out of the market and spending the investments within a variable life policy, but the concept is the same. There are some options for taking the funds out of the policy, but they are more limited than in the “buy term and invest the difference” situation.

The variable life policy gives the insured the right to select from a wide range of funds, from very conservative to aggressive growth funds. Changes to the investment allocations can be made the same as within mutual funds, except that there are no tax consequences to weigh in the allocation decision. Since these funds are like mutual funds within the insurance policy, the policy cash values and death benefits will fluctuate, reflecting the performance of the investment funds into which the policy values have been placed. Nothing is guaranteed in a variable life policy. Even the death benefit can go below the original face amount in some kinds of policies.

As with any kind of insurance policy, the death benefit goes to the beneficiary income tax free. Estate taxes may have to be paid if the policy is a part of the estate. However, with the variable life and the ability to invest in virtually the same products as you could outside the policy, there is the chance to forever avoid paying income taxes on the earnings from the investments. This feature appeals to many who are in a high tax bracket and probably will not need the funds during their lifetime. If they are in need of some of the funds, currently they can borrow from the policy up to a certain amount.

One big caution, variable life is a permanent commitment. You must never cash out of the policy or let the policy lapse unless unusual circumstances are present. If that happens, all of the investment earnings and gains within the policy over its lifetime will become taxable income to you. The cash value is not all that is taxed, since it is a net of premiums, insurance charges, and earnings. The taxable amount is the amount of earnings that have occurred within the life of the policy. This tax liability may come at a time when you have little cash available to pay the income taxes.

Buying Term Versus a Permanent Life Policy

You probably have heard variations of this saying, “buy term insurance, it is much cheaper, and invest the difference.” Following are some problems with that approach.

• If you live to your normal life span, term insurance will be prohibitive or unavailable before you die. This means that you will have no death benefit.
• If you have health problems later in life, any insurance will become too expensive or not available.

Anyone that relies solely on term insurance is taking all of the following risks:

• That they will stay healthy until later in life.
• That they will have the discipline to invest so that, later in life, insurance will not be needed to take care of the ones dependent upon them.
• That they will have the ability to invest so that insurance will not be needed to take care of the ones dependent upon them.

You cannot be sure that you will be healthy throughout your life until retirement time. Can you ensure that you will have the discipline and the ability to save and invest enough to take care of your dependents later in your life? Statistics do not back this claim up, when over 90% of sixty-five year olds are broke.

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Health and Disability Insurance

By: Walter G. Austin, Ph.D., CPA

Health insurance is a relatively new phenomenon. Due to the tremendous growth in health care costs in the last generation, these risks have to be addressed if possible. Thirty-five years ago a doctor's call could be in the $4 to $7 range. Most general practitioners start at least 20 times that amount, usually up to 25 times that. Forty-five years ago a hospital room was $17 a day. Today, both national political parties are embroiled in discussions about how best to get health insurance to the people. The Affordable Care Act is so complex and fraught with uncertainty that it will not be discussed in this course.

Disability insurance is still not thought of as being in the required insurance group. When a 30-year-old is 4 times more likely to become disabled than to die before turning 65, then why is this still the case? The common options available in a disability policy are discussed. Social Security benefits for the disabled are covered as well as the ease or difficulty in obtaining these benefits. Individual and group insurance coverages are addressed.

Health Insurance - Individual or Group

The cost of being sick in America today can be disastrous. A day in the hospital can cost several thousand dollars. A transplant operation can cost hundreds of thousands. You must have health insurance - for everyone in your family – if possible.

Normally, the best place to get health insurance is where you work. Health insurance has been part of the fringe benefits companies offer. However, employers are putting more and more of the responsibility for the cost of the insurance on their employees. Many firms will pay for the employee's insurance, but any other family coverage is at the employee's expense. Group plans normally are much less expensive than individual plans. In some cases group plans are the only available way to obtain health insurance for many people.

The rising cost of healthcare and health insurance premiums has caused businesses to begin paying mainly for major medical coverage. The amount of coverage for basic health care in health insurance policies is definitely declining. Insurance companies are pushing toward mainly major medical insurance coverage for everyone.

Disability Insurance

The definition of disability insurance is: "When a person is so incapacitated that they cannot work." Originally, and as it is still stated in some policies today, the "any occupation policy" defines disability as the complete inability of the insured to engage in any occupation whatsoever. This is a very narrow approach.

Disability insurance covers the risk that your earning power will cease for any of a number of reasons. Most people live from paycheck to paycheck. And if that paycheck does not arrive, their financial situation is in big turmoil. If you were injured in an accident or unable to work because of an illness, could you get by? How would you pay rent or mortgage payments? How would you pay bills? Where would the money come from?

Consider the following:

• A person has a 70% chance of being disabled three months or more before reaching age 65.
• A person that is 35 years old has a four times greater chance of having his earning power stopped for 90 days or more than he has of dying.
• Yet, if their employer does not have a group disability policy, most people do not have any insurance to cover that risk.

Disability insurance pays a monthly check in case of a disability that temporarily or permanently prevents you from working. The decision on whether to have disability insurance should be just as important a decision to people as life insurance. Many people understand the need for health insurance and life insurance, but far fewer understand the need for disability insurance coverage or have any disability coverage.

Do not overlook disability insurance coverage. If you do not have disability coverage, it should be because of its unavailability due to the type of your job, or because it is too expensive for your budget, or because you have decided against having it for some other legitimate reason.

Disability Insurance Options

Like other forms of insurance, disability has several options for coverage in the policy, causing varying premiums. Following are some of the more important options:

• Waiting Period Option. Policies always have a period of time after you become disabled before payments actually begin. Normally they start 60, 90, or 180 days after disablement.
• Maximum Benefit Period Option. The length of time the policy remains in effect is another important part of the policy. As long as the insured is disabled, as defined in the policy, coverage varies from a year to age 65, or even for life.
• Own Occupation Option. For a professional, an accident or injury might prevent him from working in his field of expertise, but not in some other field. Some policies pay benefits only if the insured is unable to work at any occupation, while others pay if the insured is unable to work at his own occupation. This is a most important part of the policy if you are a professional. The professional certainly would not want to be forced to work as a greeter in a department store. There is nothing wrong with being a greeter, but if a person has spent years getting the training and experience to be a professional, he does not want to have to live on the wages of a greeter.
• Benefits Option. The amount of the monthly benefits received depends on the policy. Normally the insured receives monthly from 50% to 75% of his gross pay for the period of time he is disabled after the waiting period, or for the limit of the policy, whichever is shorter.
• Cost-of-living Adjustment Option. This benefit provides cost-of-living increases in disability benefits after a certain period, such as one year. The increases usually are tied to the Consumer Price Index.
• Reasons for the Disability. The reasons normally accepted by an insurer are either for accidents alone or for accidents and sickness. Coverage of disability caused by accident only is very limited in scope and should be avoided. You should purchase policies that cover both accident and sickness.

Long-Term Care Insurance

Long-term care encompasses two basic types of services needed regularly for an extended period of time. The first is assistance with the activities of daily living. This type of custodial care often takes place in one's own home. The second is nursing home care. Home health care, by someone other than family, usually cannot be achieved for less than $50,000 per year for simple care to several times that for special care with RNs.

The annual cost of a nursing home stay averages above $70,000 nationwide and approaches $130,000 in certain metropolitan areas. Few older people have protected themselves against the very real possibility of needing long-term care. After age 65, the risk of entering a nursing home is roughly 10 times higher than losing your home to a fire. It is estimated that over 40% of adults aged 65 or older will need nursing home care at some point in their lives. Do not feel that this is only a Senior Citizen’s problem. Over 10% of nursing home patients are under 65, while over 27% of home health care patients are under age 65.

The length of a stay varies from a few months to many years. Recently, I learned of a friend’s parent that spent over thirteen years in a nursing home.

Social Security Disability Benefits

To qualify for disabled-worker benefits, you must meet two requirements:

1. You must have worked the required length of time in employment covered by Social Security. Young workers can qualify with as few as six credits (about 1.5 years of work); older workers may require as many as 40 credits (about 10 years).
2. Your disability must prevent you from being able to perform any substantial gainful work and must be expected to last for at least twelve months or result in earlier death.

Qualifying for Social Security Disability

Qualifying for Social Security disability benefits is difficult because the rules for determining disability are very strict. For this reason, you may want to consider a disability-income-protection plan in your insurance program. Even if you do qualify for Social Security benefits, you may need to supplement this income with insurance or investments to provide income during the waiting period of five full calendar months, when no Social Security benefits are paid.

These benefits are paid if you become totally disabled before you reach full-retirement age. To get disability benefits, three things are necessary:

• You need a certain number of work credits earned during a specific period of time;
• You must have a physical or mental condition that has lasted, or is expected to last, at least 12 months or to end in your death; and
• Your disability must be severe enough to keep you from doing any substantial work, not just your last job.

This amounts to an "any occupation" definition of disability and is strict by health insurance standards. In addition, the disability must last five months before benefits can begin. After five months of disability, benefits are payable if the impairment can be expected to last for at least 12 months from when the disability began or to result in death or if it has actually lasted 12 months. This amounts to a five-month waiting (elimination) period. The combined effect of the strict definition of disability and the long waiting period is largely to restrict social security disability benefits to total and severe (probably permanent) long-term disabilities.

Group Disability Income Insurance

Group health insurance is a common method of providing disability income protection for the public. The two basic kinds of plans are short-term and long-term group disability income insurance.

Short-term plans are generally intended to provide relatively modest benefits for a short period of time. They do not attempt to meet the need for protection against more serious, prolonged disabilities that can be financially catastrophic for the family.

Long-term group disability income plans are designed to take care of the more serious, long-term disabilities. Group long-term plans are characterized by benefits stated as a percentage of earnings, such as 60% of base salary. The elimination period is usually 90 days to six months. There is normally a "split" definition of disability and payment of disability benefits for maximum benefit periods such as five years, 10 years, or to age 65. To be eligible for coverage, it is common for employees to have to be aged 21 or older and employed by the employer for I year or more in some cases.

Most long-term group plans have coordination-of-benefits provisions that indicate the impact of the benefits payable to you from your group policy of other disability income benefits available to you.

Individual Disability Insurance

Despite the importance and growth of group disability income insurance, individual policies remain an important way you can protect yourself against the critical disability risk. There are several reasons why you might need individual coverage in your financial planning despite the growth of group insurance:

- You are not a member of a group that provides group insurance.
- You are a member of an insured group but not eligible to participate in the group plan.
- Your group disability income benefits may be inadequate.
- You want to provide for the short period of time until group benefits begin.
- You may need business disability insurance, such as with buy-sell agreements, or in key employee situations.

Individual disability income insurance should be analyzed in terms of the coverage, definition of disability, elimination period, maximum benefit period, and amount of coverage. The renewal provisions should be closely reviewed. The cost of the policy versus the benefit of the policy must be addressed. You should always get quotes from several companies before making a decision. Be careful that you are comparing apples with apples, since small details can impact the premium significantly.

The maximum benefit period selected should be commensurate with your needs. Do not be pennywise and pound foolish, as the saying goes. If you are 40 years old and you would need coverage to age 65, don't save premium money by getting a maximum benefit period of 15 years.

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Risk Management

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Insurance provides an important means of meeting your financial objectives. To understand this, it will be helpful to look first at the broader field of risk management. Risk analysis, basic risk management techniques, and risk transfer to others is covered. Insurance as a necessary part of your financial planning is addressed.

Risk Management

The term risk management normally means the use of all the methods of dealing with risk. Businesses are becoming aware of the benefits that can be derived from a well-developed risk management program. Although most people are perhaps less able to implement these techniques in a personal risk management situation, the knowledge of this concept can assist you in developing the proper philosophy toward handling the personal risks you face. You must manage risk or risk will adversely affect your life at a most inopportune time.

Approach to Risk Management

Risk management consists of being knowledgeable of the various forms of risk you have, determining the magnitude of those risks, and then dealing with them. The ultimate goal is the recognition of risk, then partial control of it through transferring some of it to someone else. The first steps in the risk management process are risk analysis and risk evaluation.

Risk Analysis and Evaluation

The logical start of any risk management program for you is the recognition of your risk exposures in all areas of your life. Realizing that you need automobile insurance does not qualify as a risk management program, since this is not the only exposure you will have in your life. Recognition of all your risk exposures may not be as easy as it seems. There are more exposures now than a generation ago. There are some events that are currently high risk, but which were only unfortunate happenings in the past. If you hire an outside person to work in your home, what workers' compensation exposures exist? If they are careless, do you still have risks?

Once you discover a risk, you should evaluate it to determine its cause and the probable degree of control you may want to exercise over it. For example: there is a risk of you falling when you step down from your front door. Do you insure against doing that? Not directly, but indirectly with health insurance. Since it is your front door, there is no liability to you to insure against.

What if a person fell that had been to your home? They could get seriously hurt. How do you protect yourself from this risk? Homeowner’s insurance covers liability to third parties, not your own health costs. This is a sample of the evaluation process.

Basic Risk Management Techniques

Risk avoidance is the act of eliminating risk by avoiding the causes of risk. If you choose not to drive a car, there is no risk from an auto collision. This course of action may not be desirable or practical. In some cases, risk avoidance may be quite logical. One of the factors you may consider in deciding whether to put a sunken living room in your house is whether you want to take the risk for any accident caused by the step down needed but perhaps not taken properly.

Risk reduction is loss prevention and consists of' all activities intended to prevent the occurrence of a loss. Also included are those steps taken to minimize a loss should one occur. An example of trying to prevent loss would be removing paper materials from before your fireplace. An example of risk reduction would be placing fire extinguishers in various parts of the house.

Retention of risk is the deliberate act of keeping or assuming a risk rather than transferring it to someone else. In some cases, retention is the only practical method of handling the risk, since insurance may not be purchased for such risks. In other cases, risk retention may be the most economical alternative. For example, this usually is the case with respect to the use of deductibles, which are discussed later.

Risk Transfer

Risk transfer, including insurance, consists of measures by which the risk of one party actually is transferred to another. A transfer of risk, other than by insurance, may best be explained by an example of the volunteer who supervises a scout troop on a hike. If the Scouts' parents all sign waiver agreements agreeing not to hold the volunteer liable for any injuries, the liability risk has been at least partially transferred.

Insurance is the most important type of transfer device and usually is defined as the transferring of risk to a third party (the insurance company) in return for the payment of an amount of money (the premium). The rest of this course concentrates on the use of insurance for individuals for their personal risk management.

The Insurance Principle

Not all risks are insurable. In fact, most of the risks we are exposed to in daily life are insignificant and involve minimal financial consequences. However, there are many potentially serious events, such as fire, automobile accidents, burglary, death, and disability that can cause significant losses when they occur. This is why we have insurance companies.

Insurance as a Part of Financial Planning

The management of risks is a very important part of any financial planning for you or your business. No one can avoid all risks; we must deal with them, therefore, in a logical, systematic manner. In a somewhat oversimplified way, the process you should follow to develop or evaluate a personal insurance program is summarized thusly:

1. Discover the risks in the various aspects of your life and death. Ask the question, "What can possibly happen to impact me financially in a material manner?"
2. Look for situations that can be loss producing. Analyze and evaluate each risk particularly from the standpoint of the size of a potential loss.
3. Determine which risk management method(s) should be used for each risk. That is, determine which risks can be transferred and which should be retained.
4. Plan and implement any possible loss-prevention activities, like stopping smoking or using detectors in the home.

5. Select the coverages needed.
6. Determine the amounts of insurance needed, plus any endorsements to prevent gaps or overlaps in the insurance program.
7. Consider ways to minimize property and liability insurance premium costs by increasing deductibles or dropping marginal coverages.
8. Obtain competitive quotations.
9. Select your insurance company for each risk coverage on the basis of coverage, service, and cost. The quality of service received from insurance agents or brokers is very important in making this choice.
10. Periodically evaluate and update the insurance program. A perfect program can quickly become outdated. A periodic review of all policies and risk exposures in conjunction with an overall financial planning review is desirable.

Assuming that the money for risk management is available and that the insurance is obtainable, allowing any absence of needed life insurance, disability insurance, health insurance, or property risk insurance could cause all of the other great dreaming and planning you do to be absolutely useless. Only after you cover all these risks can other facets of your future planning be effective or have a reasonable chance of attainment. One or another of the aforementioned fundamental risks, if unaddressed, could clip your dreams and plans.

Overview

Risk management has to include dealing with risks arising from your owning a home and automobiles. Homeowner’s insurance, and some of the provisions of the policy, are addressed—including the matter of your home’s replacement value. Insurance to cover your automobile, and your related potential liability risks, are discussed in this chapter. Where and how to look for insurance is addressed. Also covered is how to pick an agent to deal with your risk management.

Homeowner's Property Loss Insurance

The homeowner’s policy is an "all risks" type of coverage. The policy covers "all risks" of direct physical loss or damage except as provided in the policy. It also has liability coverage for incidents on the property. Some of the commonly used exclusions are:

• Wear and tear
• Deterioration
• Mechanical failures
• Floods
• Earthquakes
• Landslides

Floods are not normally covered. However, many flood-plane areas have been designated as eligible for flood insurance through the governmental flood insurance program. Earthquakes or landslides are also not usually covered. In most states, this coverage can be purchased by the payment of an additional premium.

Property loss insurance for your home is essential. Unless you are very rich, the loss of your home would seriously interrupt your financial picture. Whether you should have liability insurance on your home and your automobiles is not a question; it is absolutely necessary unless you want to commit financial suicide. The more resources you have, the greater becomes the need for liability insurance on both the home and the automobile. The very rich have a much greater need for liability insurance than the person who has nothing. A homeowner's insurance policy has liability coverage within the policy.

Homeowner's insurance is almost universally used. If your house is mortgaged your mortgage company requires you to have homeowner's insurance. You may pay to the mortgage company money to be put in escrow for homeowner's insurance or you may pay it yourself, with their permission. If you do not owe on your home, you will probably pay the premium annually.

Homeowner's insurance is relatively inexpensive. There are several variations of homeowners policies that may depend on the state in which you live. Some states have only a minimum number of universal homeowner's policies from which to choose. Following are some provisions with which you should be familiar.

Replacement Cost Provision

This provision is advantageous to you because if the proper percentage of home value is maintained on the dwelling, you can recover any loss. Normally the policy provides that if the insured carries insurance on a building of at least 80% of its replacement cost new, any covered loss to the building will be paid up to the policy limit. Without a replacement-cost provision, the homeowner's policy would only pay you the actual cash value at the time of the loss or damaged home. Actual cash value is the replacement cost new of the property at the time of the loss minus the amount the property has depreciated since it was built. This could cause you a great deal of pain if you cannot replace your home.

You can assure yourself of adequate coverage if you buy a special endorsement on a homeowner's policy that automatically increases the coverage limits periodically by the inflation percentage amounts.

Homeowner's Liability Protection

Daily non-business activities include a host of exposures to loss through legal liability. Your dog bites a neighbor, a visitor trips and falls in the entryway, or an errant ball thrown by your children hits a passerby. These can put you to great expense and trouble in defending against liability claims, even if they are groundless. This widespread exposure to liability losses stresses the need for a homeowner's policy with its widespread liability coverage.

In addition to providing the coverage, the insurance company also agrees to defend the insured in any suit that would be covered by the policy. This takes away a potentially large cost for attorney fees even though you might not lose the suit.

Automobile Insurance

If you have a car, you need insurance. The need for different kind of coverages on your automobile is not as simple to determine as homeowner's insurance. Automobile insurance policies typically provide coverage for physical damage to the automobile, liability, medical payments, comprehensive risks, and related exposures.

Many factors contribute to the advisability of whether you should have a specific kind of coverage. If your auto has a loan on it, insurance coverage for physical damage and basic liability will be required for an amount that at least covers the lender's risk. How much risk can you assume yourself in each of these coverages? This includes the amount of the deductibles for each coverage.

Every time you drive your car, you run various risks. You can be seriously injured or killed in an accident or do extensive damage to your car. You may be at fault or not, but the loss remains the same.

Also, think of the possibility of damage you could do to someone else. In our litigious society today, just think how much money for which you could be sued. You may not feel that too much damage was done to their property and to themselves, but when you get sued and go to court you will have a much different attitude as to the magnitude of the problem.

Personal Liability

The risk of loss of financial assets is by no means limited to the physical destruction of the assets. A potentially greater risk is the loss of assets or earnings as a result of one's negligence. Large liability judgments and settlements are common. Awards of a million dollars or more are common today. Liability insurance, for both your house and your car, is an absolute must. You could disable or end the life of a heart surgeon and be sued for millions. A legal settlement could require you to support the physician's children financially. When it comes to liability insurance in this litigious society, you must protect yourself.

If you have even moderate financial wealth or an important visible position in the community, you should have an umbrella liability policy on you for a substantial sum to protect you from catastrophic losses.

A person could be very successful in his profession, have a good life and health insurance program, be successful with investments, own a nice home, cars, and valuable personal property, yet be destroyed financially by an accident or lawsuit that is not covered by an insurance policy. This is particularly true today for liability insurance, because people in general have become so litigious.

Where Do You Get Insurance?

When you determine that you need a specific kind of insurance, first, look around at several insurance agents. Look at some agents who sell only for one company, like a State Farm or an Allstate Agent and some independent agents. An independent agent represents several companies and may be able to get you better coverage for the same price or the same coverage for a lesser price. No insurance company has the best rates on every type of automobile driver and for every type of homeowner's policy. The same insurance company may not have the better rates in a specific locality like they did where you came from. Check out rates when you change cities and states, regardless of how good they have been in the past in another location. If they are over insured in a specific location, they may raise their rates to discourage new customers.

Deal With an Agent and Company That You Can Trust

If you do not know the agent yourself, ask around about his or her reputation. Hopefully, you will not need to be doing anything other than paying premiums, but that is a very unrealistic scenario to expect. Also, if you're dealing with a good company, you're not going to get hurt. If you have not heard of the insurance company that the independent agent is representing, make sure that they are sound financially. Do not just accept any company that he gives you—you could get really hurt. The author had a very bad experience in this situation with a house fire.

Cautions

Be very careful of spreading your property and liability coverage around to different companies. For example, do not cover your van with company # 1 and your boat with company # 2. This causes problems as to allocation of responsibility in case of an accident and you would have to deal with two companies in just one accident.

It would be preferable to purchase your homeowners and an umbrella policy from the carrier with whom you have your other liability policies unless there are very good reasons to do otherwise.

Certain states have enacted "no-fault" auto insurance statutes which remove at least some auto accidents from the claims of negligence liability.

Remember that property and liability insurance premiums must be paid by the due date or coverage will expire. Property and liability insurance policies do not contain a provision similar to the grace period found in life and health insurance policies. Property and liability insurance agents may extend credit for a short period to their customers for their premium payments if they desire, but be sure. Risks are covered only to the minute that the policy expires.

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Life Insurance Continued

By: Walter G. Austin, Ph.D., CPA

Variable Life as an Investment Vehicle

The variable life policy has been touted by some as an investment vehicle rather than an insurance policy. It certainly can be used as an investment vehicle, but it should not always be classified as an investment. Following are some guidelines:

If the basic policy amount does not change until the cash value exceeds the policy amount, it is not an investment in any form. If the insurance policy is $100,000 and the investment value of the policy is $75,000, the only insurance involved is the $25,000 difference. On the other hand, given the same facts, the death benefits are only $100,000.

If the premium is sufficiently larger than the basic minimum premium necessary to keep the policy in force and the policy amount varies with the investment results, then a portion of the variable life policy can be called an investment. Always remember that a part of the premium is still for basic insurance.

The policy is an investment vehicle when the cash value of the policy is added to the face amount of the policy to get to the death benefit. For example: if a $100,000 variable life policy has a cash value of $25,000 and the death benefit is $125,000, then the policy can be deemed an investment vehicle as well as an insurance vehicle.

If the premium is such that the basic policy amount does not change for a long period of time after the purchase of the policy, it cannot realistically be called an investment. It is mainly an insurance policy.

Cautions On Projections

If you are considering the purchase of a variable life policy, do not rely on projections about the policy that have an expected investment return larger than 10%. You can be lead astray by the historical returns of an insurance company's variable life portfolio. A large majority of the variable life products that are in the market today have been started during the long bull market of the nineties, therefore their investment returns have been very high as compared to the market returns over several cycles going back thirty or more years.

Basing a decision on a projection of returns of higher than 10% is pure speculation when the policy may be in force for 30 or more years. As far as that goes, the same is true for a policy of 5 or more years. Again, no one knows the future.

Caution About Policy Loans

If you have a whole or variable life policy with a large investment value due to very good markets, be very cautious when obtaining a loan on that policy. If it reduces the market value to the point where a bad market for a couple of years could require large premiums or a lapse of the policy, it would not be a good decision. The insurance costs of the variable life policy go on regardless of the ups and downs of the market; and you need to be aware of the pitfalls of lowering the market value with loans, to the point of danger. Remember that if the policy lapses, you will have regular income of all of the gains within the policy. You may not be thinking that you have gains, but you are forgetting that insurance cost is not an expense that offsets investment gains within the policy.

The above cautions should be observed, but the variable life policy is a very viable investment vehicle. All of the advantages of variable annuities are true about variable life. Some additional advantages of the variable life policy are:

• Creditors cannot get to the cash value within the insurance policy.
• There are no income taxes ever paid on life insurance proceeds.
• If the cash value is sufficiently large, cash can be taken out income tax free.

Many people are using variable life to fund college education for their children, retirement and other uses. This may not be suitable for you, but it is worth investigating as possibly a part of your financial and estate planning.

Kinds of Life Insurance at Different Ages

Until you are into your 40s, your true life insurance costs do not rise significantly. However at that time they do start to rise seriously. Term insurance is what we think of when we talk pure insurance.

Somewhere by your early 40s, you should decide what you will do concerning term or a permanent insurance policy, assuming you have the money to choose. Let us review some of the variables involved in making that decision:

• Do you have the resources available to purchase permanent insurance?
• Do you have the discipline to buy term and invest the difference?
• Are you insurable with a good classification now?
• What is your long-term health diagnosis as far as being insurable and the classification of insurability?

Special Contracts and Clauses Overview

Many different kinds of life insurance policies, with all kinds of names, are sold now. Most such contracts really boil down to combinations or adaptations of the major types discussed. Only the more important types of special life insurance contracts are discussed below. Explanations for each of the many provisions within insurance policies are also covered.

Modified Life Insurance Policies

With this type of policy, the premiums are smaller for the first part of the life than for the remainder of the contract. It is typically a whole life contract in which the premiums are distributed so that they are lower during the first five, 10, or more years then higher thereafter. Modified life may be attractive to a young family person who wants to the protection of whole life insurance but who cannot now afford to buy a sufficient amount of whole life insurance to meet his or her family’s insurance needs.

Adjustable Life Policies
This is another type of life insurance product that allows the policyholder to change back and forth between whole life and term insurance. It also allows you to change the amounts of premiums paid for the policy during the insured's lifetime, and, correspondingly, to change the policy's death benefit during the insured's lifetime, subject to certain conditions.

Single Premium Whole Life Insurance (SPWL)
This represents primarily an investment type life insurance product. The policyholder pays a single premium, such as $5,000, $25,000, $50,000, or more, and receives a paid-up life insurance contract. The premiums may have come from an inheritance or a windfall or savings and the desire to have that risk covered. The full premium goes into the cash or accumulation value, which is credited each year with a current interest rate that will change periodically, but never go below a minimum guaranteed rate of interest. The insurance company will charge fees against the cash values to cover administration costs and mortality costs.

There is a minimum paid-up death benefit, the amount of which depends on the single premium, health conditions, the age, and the sex of the insured. The death benefit also may vary over time, depending on the investment experience, but it will never fall below the minimum initial face amount. There is normally a surrender charge if the policy is surrendered during its early years such as during the first five to 10 policy years. This diminishes on a scale after the first year and ultimately becomes zero. SPWL insurance is considered as a long-term investment.

The insured needs to be aware of the possibility of the insurance policy becoming a modified endowment policy. This takes the policy out of many of the benefits of an insurance policy. The earnings may become taxable. Experienced financial planners and their Insurance companies can overcome this problem with proper planning.

Life Insurance Dividends
One of the basic decisions in buying life insurance is whether to buy participating or nonparticipating insurance. The following information will be helpful in making this choice.

Participating life insurance shares a portion of the earnings on the insurance company's investment portfolio with the policyholder in the form of policy dividends. These are based on the actual mortality experience, the investment earnings, and administrative expenses. Policy dividends are not guaranteed. The amount of the dividend depends upon the actual investment earnings over the expenses mentioned.

Nonparticipating policies are sold with fixed premiums with no provision for dividends. Thus, the policyholder knows in advance what the cost of the life insurance will be. Under a participating policy the net premium will depend upon the gross premium and the policy dividends actually paid by the insurance company. The insured's net premium may be lower or higher than under a comparable nonparticipating contract.

Grace Period

The grace period is normally 31 days after the premium for a life insurance policy is due during which the policy remains in full force even though the premium has not been paid. This provision is designed to protect the policyholder against inadvertent lapse of the policy.

Policy Loans

The policy loan provision in a life insurance contract allows the policyholder to take a loan that will not exceed the cash (loan) value of the policy. The rate of interest that will be charged on a policy loan is normally stated in the contract. If not, it is some figure that can be determined objectively. Policy loans may have a low guaranteed interest rate difference between the current earnings rate and the rate charged on loans. These guaranteed policy loan interest rates can be advantageous to a policyholder during periods of high interest rates. Under these circumstances, policy loans can be a low-cost, readily available source of credit. Under single premium policies, the interest rate charged on policy loans up to specified amounts, such as the net interest earned by the contract in the prior year, may be lower than for policy loans above these amounts.

The policy loan provision is valuable to you as the policyholder. It enables the policyholder to draw upon cash values in the policy to meet temporary financial needs without surrendering the contract. The main disadvantage of policy loans is that when a policyholder does not repay the loan, the death proceeds going to the beneficiaries will be reduced by the amount of the loan. If the loan is large enough and it is not repaid, the insurance costs during that particular period could be larger than the premium and cause the policy to lapse or create the need for a higher premium.

Clauses

Incontestable Clause. After a life insurance policy has been in force a certain length of time, which normally is two years, the insurance company agrees not to deny a claim because of any concealment, error, or misstatement on the part of the policyholder. From the standpoint of the policyholder and the beneficiary, such a clause alleviates the fear of lawsuits after the insured's death, when it may be very difficult for the beneficiary to combat successfully a charge by the insurance company of a violation in securing the contract.

Suicide Clause. Life insurance contracts contain a provision stating that if the insured commits suicide during a certain period of time after the policy is issued, normally two years, the insurance company is liable only to return to the beneficiary the premiums paid, either with or without interest. After the two-year period, suicide becomes a covered risk and is treated like any other cause of death.

Reinstatement

The reinstatement clause is designed to help a policyholder who has failed to pay a premium within the time allowed, including the grace period. This provision usually gives the insured the right to reinstate the policy within a specified period (normally three years) of any default in premium payment, subject to furnishing evidence of insurability satisfactory to the insurer and the payment of back premiums.

This clause may be helpful to a policyholder for several reasons. For example, it may be advantageous to use the reinstatement clause of a current policy, instead of purchasing a new policy, because a new policy generally will involve a higher premium (due to higher age). The contestable periods may have run their course under the current policy. Cash values, policy loan interest rates, and other provisions may be more favorable in the current policy. Also, it may be that a newer policy currently being offered is more attractive than the current policy. In that case, it may be better to change to a newer one. This decision should be made only after a careful analysis.

Automatic Premium Loan

Similar to the policy loan is the automatic premium loan provision. This provision operates when a policyholder fails to pay a premium when due. In this event, the premium is paid out of the policy loan value. Thus, through use of an automatic premium loan, a life insurance policy can be protected against lapse if the policy owner fails to pay a premium, as long as the policy has sufficient loan value to cover the premium payment.

In many companies, the automatic premium loan provision is not included automatically in the policy but can be included at the request of the policyholder. It is a feature that should be included in policies, since it is possible for anyone to overlook making a premium payment. Also, there is no extra cost for the provision.

Beneficiary Designation

A life insurance contract allows the policyholder to select the person or persons who will receive the proceeds of the contract in the event of the insured's death. They are called beneficiaries. When the owner reserves the right to change the beneficiary, the beneficiary designation is called "revocable."

It is advisable to name a second beneficiary to receive life insurance proceeds in case the first (primary) beneficiary predeceases the insured. This contingent or secondary beneficiary can then receive the proceeds directly according to the insured's wishes. If no contingent beneficiary is named in the policy, the proceeds would go to the insured's estate if the primary beneficiary predeceases the insured.

What Actions Can an Uninsurable Person Take?

Following are some steps uninsurable persons may take.

1. See if it is possible to remove or reduce the reason for the uninsurability.
2. Check with several different insurance companies. Underwriting standards vary. A person who is considered uninsurable by one insurer may be regarded as insurable, on a substandard basis, by another company.
3. Look for sources of insurance that do not require the showing of individual evidence of insurability. Group insurance may be available through the place of employment.

Importance of Strong Insurance Company

When you buy a permanent life insurance policy in your younger years, you are betting on the ability of that insurance company to survive for those next twenty, thirty, forty, fifty, or up to seventy or more years. With a whole life or universal life policy, the insured is taking all of the risk that the company will survive. If the company does not survive, you have no insurance, no investments, and no investment earnings. Fortunately, very few policyholders have been left out in the cold, but it can happen.

This is not true with variable life. Since you are directing the investment of the funds, a separate account is set up within the insurance company books, and the results of those investments are to your sole benefit. Since these funds are yours, not the insurance company's, in case of the failure of the insurance company, those funds will not disappear with the bankruptcy. In that case the funds can be transferred to another insurance company.

Periodic Review of Insurance Coverage

All aspects of your liability and life insurance policies and coverages should be reviewed periodically. Some will need to be completed more often than others. If you have a permanent life insurance policy you will not need to review it as often as your car insurance. You will have many different cars, but only one life.

Even if you have a good permanent life insurance policy, your needs may have changed. A dependent may have become incapacitated, which would require much more insurance in order to maintain the quality of life that you wish.

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1. Risk avoidance:
A. Is the act of eliminating risk by avoiding the causes of risk.
B. Is choosing to drive a car carefully
C. Is the deliberate act of keeping a risk.
D. Consists of measures by which the risk of one party is transferred to another.

2. Which of the following statements is FALSE?
A. Not all risks are insurable.
B. Most of the risks we are exposed to in daily life are insignificant.
C. The management of risks is a very important part of any financial planning.
D. If you are careful you can avoid all risks.

3. Which of the following statements is FALSE regarding the process that should be followed to develop or evaluate a personal insurance program?
A. Discover the risks in the various aspects of your life and death.
B. Look for situations that can be loss producing.
C. Determine which risk management method should be used for all risks.
D. Select the coverages needed.

4. Which of the following responses is TRUE concerning liability insurance on your home and automobiles:
A. The more resources you have, the greater the need for liability insurance.
B. The fewer resources you have, the greater the need for liability insurance.
C. The very rich will usually self-insure.
D. Your mortgage company does not care if you have a homeowner's policy.

5. After you have determined a need for a specific kind of insurance, which of the following responses is FALSE regarding subsequent action?
A. Look around at several insurance agents.
B. Use the same insurance company you used in another city.
C. Look at some agents who sell only for one company.
D. Look at some independent agents.

6. Which of the following statements about health insurance is FALSE?
A. The trend away from managed care means that less and less people will be covered by health maintenance organizations.
B. If possible, you should have health insurance for everyone in your family.
C. Many firms will pay for the employee’s insurance and any other family coverage is at the employee’s expense.
D. For many people, group plans are the only available way to obtain health insurance.

7. Which of the following statements about disability insurance is FALSE?
A. A person has about a 10% chance of being disabled three months or more before reaching age 65.
B. A person that is 35 has a four times greater chance of having his earning power stopped for ninety days or more than he has of dying.
C. If their employer does not have a group disability policy, most people do not have any insurance to cover that risk.
D. Disability insurance covers the risk that your earning power will cease for any of a number of reasons.

8. Which of the following is FALSE? One of the more important disability insurance options is:
A. Waiting Period Option
B. Maximum Benefit Period Option
C. Any Occupation Option
D. Cost-of-Living Adjustment Option

9. Which of the following statements is FALSE about Social Security?

A. Social Security benefits are paid if you become partially disabled before you reach full-retirement age.

B. Qualifying for Social Security disability benefits is difficult.

C. You must have a physical or mental condition that has lasted, or is expected to last, at least 12 months or to end in your death.

D. Your disability must be severe enough to keep you from doing any substantial work, not just your last job.

10. Which of the following statements is FALSE regarding disability insurance?

A. Short-term plans are generally intended to provide relatively modest benefits for a short period of time.

B. Short-term plans do not attempt to meet the need for protection against more serious, prolonged disabilities.

C. Long-term group disability income plans are designed to take care of the more serious, long-term disabilities.

D. Group long-term plans are characterized by benefits stated in dollars.

11. Which of the following statements is FALSE?

A. You have no heirs and your investments will take care of your funeral expenses, then you do not need any insurance.

B. Both spouses could easily support the family of five if the other dies, so neither of them need any life insurance.

C. Premiums for a twenty-five-year-old and those for a thirty-five-year-old are close in size, so you should not buy a larger insurance amount than will be needed in the next few years.

D. A 25-year old has a family history of early deaths so she should buy the amount of permanent life insurance needed to take care of the anticipated family needs of the future.

12. Which of the following statements is FALSE?
A. The right to name a beneficiary or beneficiaries rests with the policyholder.
B. The insured generally reserves the right to designate and change the beneficiary.
C. The insured is not normally the owner of a policy.
D. Probably the most commonly used designation is one that names the insured's wife or husband as primary beneficiary, with the children as contingent beneficiaries.

13. Which of the following statements is FALSE?
A. With level term insurance the premium decreases when a new policy is obtained.
B. Term insurance is comparable to most forms of property and liability insurance.
C. Term insurance policies range from the annual renewable to a 30-year level term.
D. If the insured does not renew after the term policy ends, then dies, the insurance company owes nothing to anyone.

14. Which of the following is FALSE regarding reasons to buy term and invest the difference?
A. A spouse, child, or close relative of yours who would have depended on you has become an invalid needing increasingly expensive special care.
B. The family has a long-life history without major health problems.
C. You have the discipline to buy term insurance and invest the difference.
D. You already have enough investments that will replace the need for term insurance.

15. Which of the following statements concerning Variable Life as an investment vehicle is FALSE?
A. If the basic policy amount does not change until the cash value exceeds the policy amount, it is not an investment in any form.
B. If the premium is sufficiently larger than the basic minimum premium necessary to keep the policy in force and the policy amount varies with the investment, it is an investment.
C. The policy is an investment vehicle when the cash value of the policy is added to the face amount of the policy to get to the death benefit.
D. The policy is an investment vehicle if the premium is such that the basic policy amount does not change for a long period of time after the purchase of the policy.

16. Which of the following is NOT a variable in determining whether you will purchase term or permanent insurance in your 40s?

A. What is your short-term health diagnosis as far as being insurable and the classification of insurability?

B. Do you have the resources available to purchase permanent insurance?

C. Do you have the discipline to buy term and invest the difference?

D. Are you insurable with a good classification now?

17. Which of the following statements is FALSE? In a Single Premium Whole Life Insurance policy:

A. Represents primarily an investment type life insurance product.

B. The policyholder pays a single premium, such as $5,000, $25,000, $50,000, or more, and receives a paid-up life insurance contract.

C. The full premium goes into the cash or accumulation value, which is charged each year with a premium.

D. The death benefit is fixed.

18. Which one of the following statements concerning policy loan provisions in a life insurance contract is FALSE?

A. Allows the policyholder to take a loan that will not exceed the cash value of the policy.

B. The rate of interest that will be charged on a policy loan is normally stated in the contract.

C. The policy loan provision is not very valuable to the policyholder.

D. Policy loans may have a low guaranteed interest rate difference between the current earnings rate and the rate charged on loans.

19. Which of the following listed steps uninsurable persons should take is FALSE?
A. Just start saving more and not worry about it.
B. See if it is possible to remove or reduce the reason for the uninsurability.
C. Check with several different insurance companies. Underwriting standards vary and a person who may be considered uninsurable by one insurer may be regarded as insurable on a substandard basis by another company.
D. Look for sources of insurance that do not require the showing of individual evidence of insurability. Group insurance may be available through the place of employment.

20. Which of the following statements concerning beneficiaries is FALSE?
A. A life insurance contract allows the policyholder to select the person or persons who will receive the proceeds of the contract in the event of the insured's death.
B. It is advisable to name your estate as second beneficiary to receive life insurance proceeds since you have distribution of your estate covered in your will.
C. When the owner reserves the right to change the beneficiary, the beneficiary designation is called “revocable.”
D. It is advisable to name a second beneficiary to receive life insurance proceeds in case the first beneficiary predeceases the insured.

Question Responses

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Payment Information

Name: ____

Company/Firm: ____

Street address: ____

City/state/zip: ____

Email (required): ____

Phone: ____

Card:

☐ Visa ☐ MasterCard ☐ American Express ☐ Discover

Card number: ____

Expiration date: ___________________________

Signature: ____