

## KOFA HIGH SCHOOL SOCIAL SCIENCES DEPARTMENT

### ECONOMICS - PERSONAL FINANCE WORKSHOPS

#### # 6 - LIFE INSURANCE



*Vocabulary Keys : Words that are in **bold** = are terms that appear in one of the chapters , Words that are underlined = supplemental vocabulary . Ask questions about these words if you are not familiar with them !*

#### TOP THINGS TO KNOW

1. *All policies fall into one of two camps.*

*There are term policies, or pure insurance coverage. And there are the many variants of whole life, which combine an investment product with pure term insurance and build cash value.*

2. *Insurance is sold, not bought.*

*Agents sell the vast majority of life policies written in the U.S. because the life insurance industry has a vested interest in pushing high-commission ( and high-profit ) whole-life policies.*

3. *Whole life is expensive.*

*Policies with an investment component cost many times more than term policies. As a result, many people who buy whole life often can't afford an adequate face value, leaving themselves underinsured.*

4. *Whole life policies are built on assumptions.*

*The returns quoted by the agent come in two forms, guaranteed and non-guaranteed. The guaranteed return is fixed interest added to the policy's cash value, but the non-guaranteed are simply guesses based on projected investment returns -- not reality. And some companies keep these guesses of future returns on the high side to attract more buyers.*

5. *Keep your investing and insurance strictly separate.*

*There are better places to invest -- and without the high commissions of whole-life policies.*

6. *Buy enough term coverage to fill your needs.*

*Life insurance is no place to skimp, especially with rates at historic lows.*

7. *Match the term of the policy to your needs.*

*You want the policy to last as long as it takes for your dependents to leave the nest -- or for your retirement income to kick in.*

8. *Buy when you're healthy.*

*Older people and those not in the best of health pay steeply higher rates for life insurance. So buy as early as you can, but don't buy until you have dependents.*

9. *Tell the truth.*

*There's no sense in shading the facts on your application to get a lower rate. Be assured that if a large claim is made, the insurance company will investigate before paying.*

10. *Use the Web to shop.*

*Buying life insurance has never been easier, thanks to the Internet. You can get tons of quotes, and no pushy salespeople.*

## **TYPES OF POLICIES**

*Whole life policies, a type of permanent insurance, combine life coverage with an investment fund. Here, you're buying a policy that pays a stated, fixed amount on your death, and part of your premium goes toward building cash value from investments made by the insurance company. Cash value builds tax-deferred each year that you keep the policy, and you can borrow against the cash accumulation fund without being taxed. The amount you pay usually doesn't change throughout the life of the policy.*

*Universal life is a type of permanent insurance policy that combines term insurance with a money-market-type investment that pays a market rate of return. To get a higher return, these policies generally don't guarantee a certain rate.*

*Variable life and variable universal life are permanent policies with an investment fund tied to a **stock or bond mutual-fund** investment. Returns are NOT guaranteed.*

*The other type of coverage is term insurance, which has no investment component. You're buying life coverage that lasts for a set period of time provided you pay the monthly premium. Annual-renewable term is purchased year-by-year, although you don't have to re-qualify by showing evidence of good health each year.*

*When you're young, premiums for annual-renewable term insurance are dirt cheap -- as low as a few hundred dollars per year for \$250,000 worth of coverage. As you get older, premiums steadily increase. Level-premium term has somewhat higher but fixed premiums for longer periods, anywhere from five to 30 years.*

## *BUYING STRATEGIES*

*Getting the right policy at the right price can be incredibly easy or very difficult .*

*Life insurance is a highly competitive business, in which the sales force depends almost entirely on commissions.*

*Insurance companies pay fat commissions to their agents for selling whole-life policies -- perhaps 80 percent of your first year's premium goes to paying the agent's commission -- and the premiums for these policies are often five times that of term. By contrast, the typical commission to the agent who sells a term policy is about 10 percent.*

*It's no wonder, then, that agents push whole-life policies as if their livelihoods depend on it, because, well, they do. If whole-life policies were beneficial to consumers, our story would end here. The fact is the vast majority of those who need insurance should buy term.*

*Today, the annual premium on a \$500,000 term policy for a healthy, nonsmoking forty-year-old male might be about \$500. The same policy for a healthy woman, aged 30, might cost about \$260 annually.*

*Not long ago you couldn't buy term policies with level premiums for periods of more than 10 or 15 years. Today you can easily find 20- and 30-year term policies.*

*Agents will argue that whole-life policies are superior because you can keep them the rest of your life and build up cash in them tax-free, which can then be borrowed. That's true enough, but they don't tell you about the high fees and commissions built into whole life as well as surrender charges ( if you want to cancel the policy ) that often leave you with little or no cash value five and even 10 or 15 years after you took out the policy.*

*The point of a tax-free buildup of cash just isn't that powerful anymore, given the proliferation of IRAs, 401(k)s, and other tax-advantaged savings vehicles that have tiny commissions, much higher yields and complete portability.*

*So stick with term, and do your investing elsewhere.*

## *HOW MUCH COVERAGE DO YOU NEED ?*

*If you're going to buy life insurance, make sure you've got enough .*

*There is no simple answer to how much coverage is enough. Some financial planners say at least five to seven times your gross annual income. Others argue that you need twice as much in face value. That would mean a person making \$50,000 a year should have anywhere from \$250,000 to \$750,000 worth of coverage or more.*

*Remember, the sole purpose of life insurance is to replace your income in case you die, so that your dependents can maintain their current lifestyle.*

*Factors to consider include whether the surviving partner will have childcare expenses if one partner is out of the picture. Do you have other assets on which to draw? Will your children be out*

*of the nest soon? These, and many other factors, influence the decision on how much coverage you need.*

*Buying a whole life policy doesn't necessarily mean you are fully insured. Because of the investment component of whole life, the policies are much more expensive than term. Don't simply buy less coverage, as it defeats the purpose of buying insurance in the first place: to cover dependents.*

*Next, you've got to figure out how long you need the policy.*

*How long a term?*

*Agents like to talk about policies you can keep throughout your life. What they sometimes won't tell you is that you don't need life insurance coverage throughout your life.*

*The secret to buying a policy with the right term is figuring out how long you need to be insured. You start by estimating when your children will be out on their own and no longer in need of your financial support.*

*So if your children are 3 and 5 now, you'd probably want a policy that covers you at least until the youngest is 22, so that's about a 20-year term. But this depends somewhat on your age as well.*

*Say you also want to cover your spouse for your lost income until what would be your normal retirement age, 65, and you're only 35 now. Then you would want a 30-year policy.*

*Keep in mind that insurance gets very expensive as you leave your 50s. So you may pay more to cover yourself until 65, even if you lock in a level-premium 30-year policy when you are 35. Coverage past age 70 or so may be unattainable.*

*Life insurance is not a substitute for a retirement plan. You want to plan so that you'll have enough to live on when you retire, and you won't have to keep paying insurance premiums.*

*There are exceptions, however. People who start families late in life, or who have complex estate-planning issues, may well have a need for life insurance beyond the customary retirement age.*

*One more thing: Steer clear of so-called mortgage insurance policies, which pay off the balance on your mortgage if you die. The problem is that you are paying for a steadily declining amount of coverage, as you pay down your mortgage. It's best to include the mortgage payments in your calculations when determining how much coverage you need.*

## *THE QUESTION OF HEALTH*

*Insurance can be difficult and expensive to obtain if you are not in good health .*

*The cheapest rates, known in the business as select or preferred, go to those who are in good health and who have a family history of good health. If you take heart medication or are grossly overweight, you may pay 50 percent more than preferred rates.*

*If you smoke, have a risky occupation, or engage in risky sports like skydiving, you'll pay even more for life insurance.*

*If you fall into one of these more expensive categories, it pays to shop around. One company may charge much more than another, depending on how it estimates the risk of your condition ( that's called underwriting ). This is where a knowledgeable agent may come in very handy. Internet and phone quote services aren't set up to deal with nonstandard policies.*

*Why, some people might ask, should I tell the insurance company about negative information that will raise my rates? Well, even if you somehow get around the medical tests and other checks done before the policy is issued, you're just kidding yourself.*

*Insurers may investigate suspicious claims. If the company finds out you've lied, the claim may be denied, or your heirs could be tied up in court for years.*

*So there's a good case to be made for getting a policy early in life while you are still in good health. However, it doesn't make much sense to buy one until you have dependents.*

## **WEB SHOPPING**

*Many companies now sell life insurance on the Web, and give free quotes and advice.*

*The key to buying on the Web is to shop by price and by the company's rating. Several agencies, including Standard & Poor's and A.M. Best, rate insurers on their claims-paying ability. Stick with companies with low prices, the term you want, and a top rating.*

*Here are some links to sites that sell the policies of multiple companies:*

- *Insure.com > has quotes from over 90 companies and plenty of detail on the policies available. The site also supplies ratings for the insurers from the major rating agencies, such as A.M. Best.*
- *Insweb > has some pretty good worksheets and advice, lets you save quotes for later retrieval and lists an 800 number.*
- *Accuquote > has over 1,600 policies in its database. But you need to fill out a dauntingly long form to get a quote. The site is an independent service.*