Life Insurance.

We all understand that it's important, but learning the ins and outs of this diverse and complex pool of products can seem overwhelming.

So let's take a moment to go over the basics - what life insurance is, why it's important, how it works and what it can do for your customers.

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The Purpose of Life Insurance

So what is the purpose of life insurance? This may seem like a simple question, but the answer can sometimes be anything but easy. Each customer will face different challenges and have different goals— all of which must be considered when determining the purpose life insurance will serve in each instance.

Four Benefits

Everyone has individual reasons for purchasing a life insurance policy. For the most part, however, these reasons fall into four categories.

1. Death benefit protection: This is the primary reason for purchasing life insurance, and it's a great way to ensure a family has financial support when it's most needed. The death benefit provided by a life insurance policy can help with immediate expenses (such as medical bills, funeral costs and housing). It can also help to replace lost income, providing the loved ones left behind with a better chance of continuing their current lifestyle.
2. Cash accumulation: Life insurance can be useful as part of a diverse investment portfolio. Universal and whole life products offer the opportunity to accumulate cash value, meaning a portion of the premium payment (the cash-value portion) earns interest. The gain in the cash value is tax-deferred until withdrawn. Policy owners typically have access to these funds through loans and withdrawals. These funds can help customers manage emergencies, supplement their retirement income or assist with college expenses.
3. Income tax benefits: Typically, the death benefit on a life insurance policy transfers to beneficiaries free of federal income taxes. Additionally, all cash value accumulation in universal or whole life policies is tax-deferred, meaning these earnings are not taxed until withdrawn.
4. Estate planning: Regardless of the size of an estate, this can be a major consideration. Integrating life insurance into an estate plan can offer a number of benefits including:
   - Helping families avoid conflict. An appropriately sized death benefit can equalize the inheritance of heirs, particularly when illiquid assets are involved.
   - Providing estate liquidity when needed. A death benefit can help ensure that immediate cash is available to satisfy creditor claims, pay taxes and settle estate expenses without having to liquidate other assets.
   - Expanding the estate available to heirs. This is a direct result of the death benefit typically exceeding the premiums paid.
   - Providing funds for trust beneficiaries. Trusts funded with life insurance are unique because they can be structured to accomplish specific estate planning goals more effectively than most other estate planning tools. The most common use of a trust is an irrevocable life insurance trust (ILIT) to ensure that life insurance proceeds will pass outside of an estate. The ILIT provides liquidity for the estate to sell assets to the trust so the estate has cash to pay any taxes and expenses. Other common uses for trusts are to protect the death benefit from a beneficiary's creditors and to make a charitable donation while still providing for family members.

Necessary Calculations

When you're helping a customer with a policy, two calculations will be very important: determining how much coverage is needed and assessing life expectancy.

Determining the amount of coverage

In order to complete the first of these calculations, you'll need to help customers estimate the economic value of their life and the needs of their beneficiaries. When analyzing these things, it's good to focus on:

• Income. How much does the customer earn and how much is expected to be earned if the customer doesn't die prematurely?

TIP: A good way to determine this figure is to assume a consistent salary increase of 3–5 percent per year.

• Cost of living. Take into account living expenses for the whole family, any important savings such as a college or vacation fund and larger debts.

TIP: Don't forget to include the cost of a life insurance policy premium.

• Medical costs. These are very difficult to estimate, but be sure to take into account the medical coverage currently in place. Many experts say that approximately three months' worth of living expenses is a good rule of thumb.

• Estate taxes. Depending on the size of the estate and the current tax laws, this may come into play for estates not transferring entirely to a spouse. Heirs may need liquid assets to pay the taxes due.

• Final expenses. Funeral and burial expenses can be much more than anticipated, running up to $10,000 in many cases. It is a sizable expenditure that should be accounted for up front.

• Future expenses. Building in future expenses that can be foreseen is critical. Also be sure to add in perhaps around 10 percent of the annual income to account for unplanned costs.

Assessing life expectancy

This process involves estimating how long a customer will most likely live. You will need to take into account current age, health and lifestyle. Also consider how the current age of the customer may impact the life insurance need.

A younger individual may have lower living expenses, a younger spouse who would need to save for retirement and younger dependents who may require greater income replacement. The reverse would be true for an older individual.

Life expectancy calculations are important because they can help people decide how many years they may need life insurance to provide replacement income to a surviving spouse or children.

TIP: You can find advanced online calculators to help you assess life expectancy which take health history and lifestyle into consideration.

Life Insurance Myths

Throughout the process of discussing life insurance with a customer, many common myths may surface. Take the opportunity to dispel these misunderstandings and provide the customer with accurate information.

MYTH: Only people with kids need life insurance.

FACT: While it is common for an individual to need more life insurance when dependents are in the picture, even people without children may leave behind joint debts, funeral expenses and other bills that need to be paid. Life insurance can also provide a spouse with income replacement during a difficult time and serve as part of a diversified investment portfolio.

MYTH: Life insurance is unnecessary for older people.

FACT: Many older people actually need more life insurance. The reasons for this vary but could include less time to make up for a loss of income, inflation cutting into the value of an existing life insurance benefit, the need for estate planning or business ownership that requires succession planning.

MYTH: Life insurance is only necessary for older people.

FACT: Younger individuals may be less likely to die, but they are much more likely to leave behind a younger family that may struggle financially without the help of income replacement from a death benefit. It's also a great time to buy because younger people will get better rates. And by purchasing a policy, they are guaranteed the existing coverage if something happens to them.

MYTH: All life insurance policies are the same.

FACT: Each life insurance product will have its own set of benefits, so it is crucial for people to consider what they want out of their policy and match that with a specific product that can best meet their needs. But this doesn't just apply to the choice of term, whole, fixed universal or variable universal. Policies within each of these categories can vary significantly. This is why life insurance should never be selected based on price alone.

MYTH: Life insurance is too expensive.

FACT: There are a lot of life insurance options out there. It may be simpler than many people think to find a product that meets their needs and their budget. And typically, the younger they are, the less expensive a policy will be.

MYTH: People with health problems can't get life insurance.

FACT: These individuals may not be able to obtain a policy for the same price as a healthy adult, but that doesn't mean they can't get coverage. Many companies have a thorough underwriting process involving adjusted rates and special considerations for these situations.

MYTH: The life insurance through my employer is enough.

FACT: In some cases, this may be true—as long as there are no dependents or major debts. But the potential for job loss can leave people without coverage when they need it.

MYTH: Term life insurance is always a better choice than whole or universal life insurance.

FACT: While the premium for a term life policy can be less expensive in the short term, the cost of coverage with other types of policies that provide a cash value can be much less over time.

MYTH: Life insurance doesn't need to be updated.

FACT: Life changes. And, so do life insurance needs. That's why it's important for individuals to review their coverage periodically to make sure no updates are needed.

TIP: Schedule a regular policy review with your customers every year or two.

Types of Life Insurance

There are essentially *four main types* of life insurance you and your customers may want to consider, each with its own pros and cons.

Term Life Insurance

Term life insurance is the most basic, and usually the least expensive, type of insurance. This product category offers insurance protection for a specified period of time and can provide a tremendous sense of security. Unlike other types of life insurance, however, term life insurance does not have an investment component. There is no potential for cash accumulation, and the policy does not have any value beyond the death benefit.

Term insurance is typically purchased by individuals who need coverage for a temporary period of time or who need a large amount of insurance at a low cost. Many of these products are renewable. After each term is up, policy owners will have the opportunity to extend coverage for an additional period of time. But at this renewal point, the premium payment will most likely increase substantially. This option can be convenient, but make sure customers are aware of age limitations. Companies typically have an age cutoff, at which point a term policy can no longer be renewed. The maximum renewals are typically between ages 85 and 95.

Another benefit to look for with term life insurance is the ability to convert the policy to a whole or universal policy without providing additional evidence of insurability. This could be a significant benefit if an insured individual develops health problems or advanced risk factors. It is also beneficial when customers have the financial ability to pay the higher premium of a whole or universal life policy and are looking to take advantage of cash value accumulation.

TIP: Generally, a customer can only convert in the early policy years (10–20 years). You may want to schedule time to explain this option to your customer prior to the end of the convertibility period.

Whole Life Insurance

Whole life insurance is a form of permanent insurance, which means the policy remains in force throughout the life of the insured individual (assuming on-time premium payments). The death benefit and premium payments for this type of policy will not change. This type of coverage can be useful for customers looking to cover final expenses.

This product category is capable of building cash value and comes with a minimum guaranteed rate. The actual rate of return received on the cash value investment, however, is dependent on the ability of the insurance company to invest and manage expenses successfully.

With accumulated cash value comes the added benefit of being able to borrow against the cash value at a reasonable interest rate. If the loan is not paid back before the insured individual dies, the amount owed is subtracted from the death benefit.

Even though whole life policies are designed to be permanent, coverage can be terminated by the policy owner. At this point, a surrender value would be paid out equal to the amount of cash value that has accumulated. If there is an outstanding loan against the policy, that difference is deducted from the surrender value.
There are two general types of whole life insurance policies: participating and nonparticipating.

- **Participating:** All values related to the policy (death benefits, cash surrender values and premiums) are estimated at policy issue. If the future claims are overestimated, the insurance company shares the excess with the policyholder by way of policyholder dividends. In many situations, policyholder dividends are not taxable.

- **Nonparticipating:** All values related to the policy (death benefits, cash surrender values and premiums) are determined at policy issue for the life of the contract. The insurance company assumes all risk of future performance. If future claims are underestimated, the insurance company makes up the difference. If the company's estimates on future death claims are high, the insurance company will retain the difference.

Fixed Universal Life Insurance

Fixed universal life insurance is a type of permanent coverage that offers increased flexibility. Customers can choose the amount of both the death benefit and the premium to be paid. As needs change over time, the amount of coverage and premium amount may be adjusted. Increases in coverage, however, may require underwriting approval.

When a customer makes a premium payment, part of the premium covers the policy's expenses and cost of insurance charges; the other portion goes into a cash account. The cash account accrues interest at a fixed rate. This rate is subject to change, generally on a quarterly or monthly basis. The way cash value accumulates for this type of insurance can make it a great addition to a customer's portfolio. All cash value that's invested grows tax-deferred.

Cash accumulation within fixed universal life insurance also provides customers with the ability to take out policy loans at low, fixed-interest rates or make withdrawals. This additional access to funds adds to the flexibility of a fixed universal life product, but keep in mind that either of these activities will affect the death benefit and the cash value and will also trigger income taxes.

In addition to the traditional fixed universal life products, this category offers a few variations:

- **Indexed universal life:** Cash value can be allocated to a fixed account, an equity index account or both. The link to the equity index allows cash value to grow at a potentially higher rate than would be possible with traditional fixed universal life insurance. The policy remains protected from downside risk by a minimum floor. A number of indexes are used to calculate indexed interest. Some common indexes include the S&P 500® Composite Stock Price Index, the NASDAQ-100® Index and the Russell 2000® Index. Some products also offer international and foreign indexes.
  A number of different methods can be used to calculate the indexed interest rate. Some common methods include annual point-to-point, point-to-point over a specified number of years and monthly averaging. It's important to read the agent guide to understand how the company determines the indexed interest rate. The indexed interest rate has a floor, which is the minimum interest rate that is guaranteed to be credited to the account. The rate may also have a cap, which is the limit on the percentage of indexed interest that can be credited over the specified time period. The floor and cap rates are subject to change over the life of the policy.
- **Guaranteed universal life:** The death benefit is guaranteed for a specified period of time, some as long as the insured's lifetime, as long as planned premium payments are made on time. With a guaranteed universal life insurance policy, it's important to know whether a policy has a catch-up provision and how the provision works since these policies are more sensitive to missed premium payments.
- **Survivorship universal life (second-to-die)**: Two individuals are covered under one policy and the benefit is paid out after the second insured individual dies. This works well for estate planning situations in which the proceeds are used to pay estate taxes.
- **First-to-die life insurance:** Two individuals are covered under one policy, and the benefit is paid out after the first insured individual dies. This works well to protect the living spouse and children as well as to pay off a mortgage or other debts.

Just as with whole life, this permanent coverage can be terminated by the policy owner. Many times, companies will apply a surrender charge at this point—usually a small percentage of the total cash value— that will be deducted from the surrender value, which is equal to the amount of cash value accumulation in the policy. The surrender charge is generally imposed only in the first 10–20 years.

Variable Universal Life Insurance

Variable universal life insurance is another form of permanent coverage. The death benefit will be paid as long as there is enough cash value in the policy to cover the policy costs. The difference here is that cash value is invested in subaccounts set up to operate similarly to mutual funds, and the amount of the cash value is tied directly to the performance of those subaccounts.

When it comes to cash value accumulation, this category gives policy owners more control. Instead of earning a fixed interest rate, they have the choice of investing cash value in one or a variety of subaccounts. This provides the potential for a higher rate of return than what is typical of a fixed universal life product but also carries additional risk. If the selected investments decline, cash value can be lost. This could force customers to pay additional premiums to keep the contract in force and could even put the policy in jeopardy of lapsing.

The cash value still accumulates on a tax-deferred basis for this type of coverage, and policy loans and withdrawals provide access to cash value. However, there may be restrictions on which subaccounts can be accessed in this manner. Premiums will vary with this life product. The death benefit can also fluctuate based on the cash value, but many policies come with a minimum death benefit guarantee.

Product Selection

Keep in mind, the most important thing is to carefully consider the needs and goals of customers and explain the different options to them. You want to help them purchase the product that's suitable for them.

Loans or partial withdrawals can reduce the policy's cash value and death benefit, can increase the possibility of policy lapse, and may result in a tax liability. Refer to Page 19 for a more complete discussion of the taxation of life insurance. Consult a tax advisor for additional information on the tax treatment of loans or withdrawals from a life insurance policy.

Life Insurance Needs Analysis

You can't pinpoint the amount of life insurance you should buy down to the penny. But you can make a sound estimate if you consider your current financial situation and imagine what your loved ones will need in the coming years.

Client name:____ Date:_____________________

Agent name: ____

Income Needs

1. What annual income would your family need if you die today? This amount is typically between 60% and 80% of total income. $_________________________

2. What annual income is available to your family from other sources? Enter a number that includes dividends, interest, social security benefits & any other sources of income. $_________________________

3. Amount of annual income to be replaced. (subtract line 2 from line 1) $_________________________

4. Capital needed for income. (multiply line 3 by the appropriate factor below) $_________________________

Years income is needed	10	15	20	25	30	35	40	45	50
Factor	8.8	12.4	15.4	18.1	20.4	22.4	24.1	25.6	26.9

Expenses

5. Funerary & other final expenses. Typically the greater of $15,000 or 4% of your estate. $_________________________

6. Mortgage and other debts. Include mortgage balance, credit card debt, car loans etc. $_________________________

7. College costs. 2016-2017 average annual cost at four-year public colleges and universities: $20,090 (in state), $35,370 (out of state), $45,370 (private).

	Annual amount	X	# of years	Total cost ($)
Child 1	____________________	X	__________	$_________________________
Child 2	____________________	X	__________	$_________________________
Child 3	____________________	X	__________	$_________________________
Child 4	____________________	X	__________	$_________________________
Child 5	____________________	X	__________	$_________________________
			Total college costs	$_________________________

8. Total capital required. (add lines 4,5,6 and7) $_________________________

Assets

9. Savings and investments. Bank accounts, CDs, stocks, bonds, mutual funds, real estate/rental property etc. $_________________________

10. Retirement savings. IRAs, 401(k) plans, SEPs, pension and profit sharing plans $_________________________

11. Current amount of insurance. Include group and personal insurance. $_________________________

12. Total of assets. (add lines 9, 10 and 11) $_________________________

13. Estimated amount of life insurance needed. (subtract line 12 from line 8) $_________________________

Life Insurance Fact Finder

Note to Financial Professional: Please work with your client to complete this fact finder.

Advisor Information **Date:**________________

Advisor name:____ Phone:________________

Client Information *(If more than one client, please fill out an additional Client Information page.)*

Client name:____ DOB:________________ State:________________

Has tobacco use status changed since the current policy was issued? Yes_____ No_____

Has the client ever used tobacco in any form (cigarettes, cigars, chew, e-cig, etc.)? Yes_____ No_____

If YES, please specify the form of tobacco and quantity used: ____

If the client no longer uses tobacco in any form, when did he/she quit? ____

Has health status changed since the current policy was issued? Yes_____ No_____

Any weight change (+/- 10lbs or more) in the last year? Yes_____ No_____ If YES, how much? _______

Please indicate the reason for weight change (if any):____

Client current build: Height _______ft ________in Weight ______________lbs

List all medication(s) including dosage:____

____

Does the client have any immediate family members who have been diagnosed with or died from cancer, heart attack or diabetes? Please indicate age(s) of onset and/or cause(s) of death:____

____

Current blood pressure:__________/___________ Current cholesterol level: __________ Ratio: ________HDL ________LDL

Is the client a U.S. citizen? Yes_____ No_____ If NO, please note immigration status: ____________________________________

Please check all the applicable boxes for avocations or medical impairments below.
Complete the corresponding questionnaires available on our website at https://theasagroup.com/underwriting-qa/

____ Aviation	____ Diabetes	____ Lung Disorders	Other:
____ Cancer	____ Drugs & Alcohol	____ Racing	
____ Cardiac	____ DUI/DWI	____ Scuba Diving	
____ Criminal Background	____ Foreign Travel	____ Sleep Apnea	
____ Depression	____ Hypertension	____ Sky Diving	

List all doctors seen within the last five years:

Name & Specialty	**City, State**	**Phone Number**	**When? Why?**
________________________________	_______________	_______________	________________________________
________________________________	_______________	_______________	________________________________
________________________________	_______________	_______________	________________________________
________________________________	_______________	_______________	________________________________
________________________________	_______________	_______________	________________________________
________________________________	_______________	_______________	________________________________

Policy Goals and Product Design

What is the total current life insurance in-force? $________________________________

Indicate below the reason life insurance was purchased. Has this reason changed? Yes_____ No_____

____ Survivor needs ____ Key person ____ Business continuity ____ Retirement income ____ Estate planning ____ Other

How much death benefit is required? $_______________/ ____ level ____ increasing

Do you want death benefit guarantees? Yes_____ No_____

What type of coverage is currently needed?

____ Survivorship insuring both lives ____ Single coverage (client's life) ____ Single coverage (spouse's life)

What is the primary concern, if improvement is possible?

____ Increased death benefit ____ Reduction of premium ____ Extended coverage duration

How long of a policy duration is required?

____ Lifetime ____ Age 110 ____ Age 105 ____ Age 100 ____ Other, to age ________

How long will premiums be paid? ____ Level premiums for life ____ Level premiums for ________ years

____ Other (describe) ____

Would you like to avoid the Modified Endowment Contract (MEC) statute? Yes_____ No_____

Does the client have a need for Long Term Care (LTC) insurance? Yes_____ No_____

If VUL, what is the hypothetical gross rate? __________________%

Information on Existing Life Insurance

A separate section should be prepared for each existing policy. Please fill out as completely as possible.

Current insurance company _____________________________ Policy number ____

Policy issue date: ___________________ Cash surrender value $_______________ Death benefit $_____________________

Billed premium $___________________ Actual paid premium $_______________

Type of policy (check one): ____ Universal life ____ Variable universal life

____ Term ____ Group term ____ Participating whole life

____ Non-participating whole life ____ Graded premium ____ Other

Who is the owner of this policy? ____

Who is the beneficiary of this policy? ____

Is the policy ____ single-life or ____ joint-life? Is this policy an MEC Yes_____ No_____

Are there loans on the existing contract? Yes_____ No_____ If Yes, loan amount $__________________________________

What is the premium basis (total premiums paid to date)? $____

Information on Existing Life Insurance (2)

Current insurance company _____________________________ Policy number ____

Policy issue date: ___________________ Cash surrender value $_______________ Policy issue date: ___________________

Billed premium $___________________ Actual paid premium $_______________ Billed premium $___________________

Type of policy (check one): ____ Universal life Type of policy (check one):

____ Term ____ Group term ____ Term

____ Non-participating whole life ____ Graded premium ____ Non-participating whole life

Who is the owner of this policy? ____

Who is the beneficiary of this policy? ____

Is the policy ____ single-life or ____ joint-life? Is this policy an MEC Yes_____ No_____

Are there loans on the existing contract? Yes_____ No_____ If Yes, loan amount $__________________________________

What is the premium basis (total premiums paid to date)? $____

Information on Existing Life Insurance (3)

Current insurance company ______________________________ Policy number ____

Policy issue date: ___________________ Cash surrender value $_______________ Policy issue date: ___________________

Billed premium $___________________ Actual paid premium $_______________ Billed premium $___________________

Type of policy (check one): ____ Universal life Type of policy (check one):

____ Term ____ Group term ____ Term

____ Non-participating whole life ____ Graded premium ____ Non-participating whole life

Who is the owner of this policy? ____

Who is the beneficiary of this policy? ____

Is the policy ____ single-life or ____ joint-life? Is this policy an MEC Yes_____ No_____

Are there loans on the existing contract? Yes_____ No_____ If Yes, loan amount $____________________________________

What is the premium basis (total premiums paid to date)? $____

Audit Output Request

To qualify for a full audit you must have at least $5,000 in annual premium or $50,000 in cash surrender value.

The Life Insurance Application Process

Once you've helped customers decide which product best fits their needs, it's time to go through the application process.

Application

Applications can range anywhere from five to twenty-five pages. It's important to fill out the application entirely and not skip any questions. You can prefill any known information about your customers, but they must review it as they complete the remainder of the application.

Many companies also have an electronic application. If you are comfortable with this submission method, using it can help you reduce turnaround times significantly, resulting in increased placement ratios.

TIP: With all of the changes in insurance industry regulations, application forms can change often. You may want to consider downloading new application packets regularly to ensure that you are using the most current version of the application. Most companies make these available to agents on its website.

Underwriting

Before a policy can be purchased, customers must be approved by meeting specific requirements. The underwriting process helps the insurer determine how much the premium payment should be, based on the level of risk posed by each customer.

When an individual applies for coverage, the company reviews a number of personal factors, including:

- Age and gender
- Insurable interest
- Current health and medical history
- Family medical history
- Driving history
- Personal habits
- Occupation and hobbies

Calculating age

Age can be calculated using two methods - age last birthday and age nearest birthday. Age last birthday uses the insured's actual age based on their last birthday. Age nearest birthday calculates the insured's age based on the age the insured is closest to. If the insured has recently had a birthday (for age last) or has moved within six months of their last birthday (for age nearest), it may be possible to have the policy back- dated to save age. When back-dating, the customer will be required to pay premiums beginning with the day the policy was back-dated to.

TIP: When using a quoting system, it is important to input the insured's date of birth rather than age. This will help ensure that the premium amount quoted reflects the age calculation method used by the insurance company.

Determining insurable interest

One of the key principles of underwriting is that the beneficiaries and owners should have a valid interest in the continued life of the proposed insured. This is often referred to as an "insurable interest." Insurable interest represents a probable financial loss to be suffered by the beneficiary/owner should the insured die prematurely. Generally speaking, a loss that would be as great as the total amount of life insurance contemplated. A person has an insurable interest in the life of another when there is a reasonable expectation of financial gain from the continued life and a financial loss resulting from the untimely death of the other person. Whether an insurable interest is acceptable may be subject to state-specific regulation.

The following beneficiaries may generally be assumed to have an insurable interest in the life of the proposed insured:

- Spouse, fiancé(e), domestic or civil partner (where allowed by law), child, parent, grandparent, brother or sister.
- Business partners or employers (if the insured person is a director, officer or high-level employee).
- Charitable organizations (if the proposed insured has a history of giving to the named charity and already has sufficient personal insurance in force).

If a beneficiary other than those listed above is named, the underwriter may seek answers to the following questions:

- Why was the beneficiary named?
- What was the purpose for the coverage?
- Will the beneficiary suffer a financial loss in the event of the death of the proposed insured?

Obtaining information

Insurance companies will obtain necessary underwriting information through a number of sources. The primary source of information is the insured. The application will include a number of questions to help the underwriter assess risk. It's important for individuals to be honest and up-front when completing a life insurance application. If any material omissions are found, the policy could become null and void—leaving beneficiaries without the financial security they need.

Medical underwriting generally includes an exam completed by an approved paramedical facility. This exam will include measurement of weight, height, blood pressure and pulse; blood work to check cholesterol, glucose, protein and HIV; and a urinalysis to check for the presence of protein, glucose, creatinine and cocaine. With larger face amounts and older applicants, a full exam completed by a doctor may be required. Other common tests that may be requested include an EKG, a stress EKG and a word recall test. Companies also typically order a motor vehicle report on each insured individual.

Generally, the insurance company will request all medical records and exams within a few days of receiving the application. They will also cover all of the expenses for any necessary exams.

For larger coverage amounts, the insurance company will also ask for financial information. Financial underwriting ensures that the insured's coverage does not exceed the amount of the beneficiary's insurable interest. The amount of coverage allowed and the way it is calculated vary greatly from company to company. Most companies complete basic financial underwriting using a multiple of the insured's current income. However, underwriters are able to look at each customer's individual financial information and make exceptions to these standard calculations. For significant face amounts, generally $1 million or larger, an inspection report will be ordered. The inspection report will verify income and net worth.

The writing agent is an important source of information. A well-written cover letter explaining how the face amount was determined and the reason for the insurance will typically give the underwriter a better understanding of the case and result in quicker issuance of the policy. The writing agent should include information regarding the background of the sale and the purpose and need for the insurance. Be sure to clarify any unusual or unique aspects of the case. List all amounts of life insurance in force and the amount, if any, being replaced. Copies of an estate planning analysis and available financial statements should accompany the cover letter.

Assigning a risk classification

Once the insurance company receives this information, it is reviewed by a trained underwriter. The underwriter then determines which risk classification the customer falls into.

All companies have different classifications, but they fall into the following general categories:

- **Preferred** – Individuals with below-average risk (divided by smoker and nonsmoker)
- **Standard** – Individuals with average risk (divided by smoker and nonsmoker)
- **Table rated** – Individuals with above-average risk
- **Flat extra** – Individuals who pose an unusual risk (i.e., engaged in hazardous activities) NOTE: Flat extras are generally a specified dollar amount extra per year, and they can be either permanent or temporary.
- **Declined** – Individuals who are uninsurable and will be denied coverage entirely

TIP: All companies assess risk differently. Most companies can provide you with an underwriting guide that includes their general guidelines and procedures.

Premium Payments/Binding Coverage

Once the application has been filled out, your customers will want to know when their coverage begins. Qualifying individuals can choose to bind coverage, which means they will be covered during the application process. In order to bind coverage, a premium payment is needed up front with the application. If the policy is not issued, the binding premium will be returned.

If the policy does not allow for binding coverage or the customer does not qualify, you should not collect premium payments at the time of application. Once the policy is approved, you will need to collect a check for the premium amount.

Typical Timelines

First, there really is no "typical" timeline. The process varies greatly from company to company. It also varies based on the number of underwriting requirements that must be collected and reviewed as well as the type of policy being applied for. It could take anywhere from four to 12 weeks for a policy to be issued.

Below are rough timelines for specific pieces of the process:

- Most applications are input into the system and begin processing within 24–48 hours of the company receiving them.
- Exams, medical records, inspection reports and motor vehicle reports are generally ordered within an additional 24–48 hours.
- Paramedical exams are typically received within seven days of exam completion.
- Medical records ordered from a doctor generally take 14 days.
- Companies usually allow three to six weeks for the agent to deliver and place the policy.

Reinsurance

Insurance companies will occasionally use reinsurance, which is basically insurance for the insurance company. The main benefit of reinsurance is that it transfers some of the risk to another insurer, thus spreading the risk pool. The amount of risk retained by the insurance company under the reinsurance agreement is referred to as the retention limit.

Almost all insurance companies use a reinsurance program. This type of arrangement allows an underwriter to approve policies with higher limits than would otherwise be allowed by the insurance company. The insurance company generally has an automatic binding limit, which is the maximum amount to which a company can bind reinsurers on their own authority without sending the reinsurer the underwriting file. There is also a jumbo limit, which is the maximum amount of life insurance that may be in force and applied for in all companies without sending the reinsurer the underwriting file. If the amount applied for exceeds these limits, the underwriting file must be sent to the reinsurer for a facultative review.

Policy Customization

Just like anything else, there is no one-size-fits-all solution for life insurance. So policy customization is vital to ensure that customers' needs are fully met. When customizing life insurance, consider death benefit options, a variety of riders and the potential use of loans and withdrawals.

Death Benefit Options

Three primary death benefit options exist for those purchasing universal life insurance:

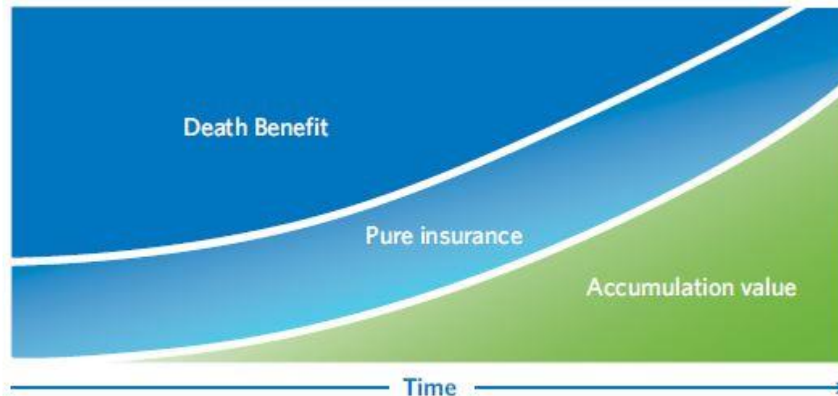
- **Option 1** – Level death benefit equal to the face amount
- **Option 2** – Increasing death benefit equal to the face amount plus policy value
- **Option 3** – Increasing death benefit equal to the face amount plus premiums, less withdrawals

Selecting option 1: Level death benefit

With option 1, the death benefit is equal to the face amount. As the cash value in a policy begins to approach the face amount, the amount of pure insurance declines. Option 1 will generally be less expensive because the amount of pure insurance the customer is paying for declines over time.

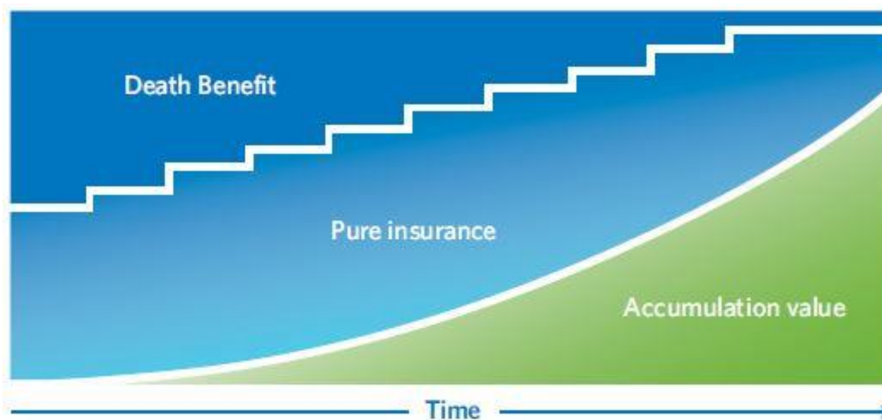
Selecting option 2: Increasing death benefit

With option 2, the pure insurance amount remains the same throughout the policy. The cash value accumulation is what leads to the increasing death benefit amount. That's why the exact death benefit isn't known until the insured dies. Option 2 requires a higher premium because the pure insurance protection is never reduced by the increasing cash value like it is with option 1.



Selecting option 3: Face amount + premium payments - withdrawals

With option 3, the pure insurance amount also remains the same throughout the policy. The cash value accumulation and premiums (reduced by any withdrawals) are what lead to the increasing death benefit amount. As with option 2, the exact death benefit isn't known until the insured dies. Typically, option 3 must be elected at the time the policy is issued.



Not all options will be available with all product types, but choosing the option that best aligns with a customer's intended policy use will help ensure that the coverage matches the need.

Riders

No matter which type of life insurance a customer selects, a series of riders will be available to help tailor the policy and provide additional advantages. Common rider categories include:

- **Accidental death benefit** – An increased death benefit if the insured's death is due to a covered accident. This supplemental benefit is normally purchased by younger individuals because death at a young age is often due to an accident rather than an illness. This rider allows for protection of a young family with greater amounts of coverage at a relatively low additional cost.
- **Continuation/waiver of premium** – Automatic continuation or waiver of premium payments if certain events occur. These events could include total disability, confinement to a long-term care facility or unemployment. Continuation of premium applies to universal life insurance policies. Customers will need to select the amount of premium the life insurance company will continue to contribute to their policy. For term policies, the premium will be waived.

- **Child term** – Coverage provided for a child at a preset rate. A child term rider can generally be converted to an individual permanent policy when the child reaches a specified age.
- **Additional insured** – Coverage provided for an additional adult on the same policy. This rider pays a death benefit only if the additional insured dies before the primary insured. Unlike coverage with a child term rider, additional insured rider coverage is generally not convertible to an individual policy.
- **Guaranteed insurability** – The opportunity to increase coverage without underwriting at predetermined points throughout the life of the insured. This may be beneficial for customers who know their health could change in the future or who have a family history of medical problems.
- **Living benefits/advanced payment of death benefit** – Early payment of a portion of the death benefit for specified reasons such as terminal illness or permanent confinement. Individuals who take advantage of the accelerated death benefit for terminal illness generally have less than one year to live and use the money for medical treatments.

While many riders are optional and carry an additional charge that is either predetermined or based on issue age and other factors, some are automatically included in a policy without any additional up-front costs.

Premium Payments

The premium for term insurance and whole life insurance will be a set amount. For universal life insurance, customers can choose how much they would like to pay (within IRS premium limits) as long as the minimum payment required by the insurance company is made. Any amount paid over the cost of insurance and policy expenses will be put into the policy's cash value and will accumulate interest.

Making payments

Policy owners can choose to make premium payments annually or over shorter durations including semiannually, quarterly and monthly. For term insurance, the payment is often less when made annually.

Most companies allow customers to pay using automatic deduction or check. Some now even allow customers to pay using a credit card. Typically, if you are paying monthly, you must be signed up to pay using either automatic deduction or a credit card.

Depending on the type of policy, limited-pay or single-pay options may also be available.

Missing payments

It's important that customers pay their premiums on time. If customers do not make their minimum premium payment, however, they will most likely still have coverage immediately after their payment is due. Most companies have a grace period of 30 days for customers to pay their premium. After that, the policy may be cancelled.

Customers with a universal life insurance policy that has accumulated a cash value can use the cash value to pay for the cost of insurance.

TIP: If your customer cannot afford to make the payment, assess the situation to see if there is a way to reduce the policy cost (i.e., switching to a different type of policy, lowering the coverage amounts or switching to a different modal payment plan).

Policy Loans and Withdrawals

The ability to take out loans and make withdrawals from a life insurance policy's cash value can provide customers with flexibility that may become important as life changes—sometimes unexpectedly. Before recommending one of these strategies over the other, it is vital to understand how each works.

Withdrawals

Withdrawals can be taken from whole and universal life policies. By making a withdrawal, customers are permanently removing a portion of the cash value. This option may come with fees, but no interest is charged.

One thing to keep in mind when considering a withdrawal over a loan is that a withdrawal cannot be repaid to the policy. This will permanently reduce the death benefit and may be taxable.

Loans

Policy owners have the option to borrow money from the cash value that has accumulated in their whole or universal life policy. If the loan is not repaid, the amount owed is deducted from the death benefit. As long as a policy is not a modified endowment contract and is kept in force, loans on the cash value are generally income tax-free. This can be a great way to cover emergencies, supplement other college savings vehicles, or supplement retirement income without facing immediate tax consequences.

One thing to keep in mind when considering a loan over a withdrawal is that a loan must be monitored to ensure that the policy does not lapse and trigger a taxable event. Some policies have an additional feature that helps protect the policy from unintentionally lapsing due to the loan. This is an important feature to look for if your customers are planning to take loans from their policy in the future.

Benefits of taking a loan from a policy may include the lack of fees, timely availability of funds and no connection with the policy owner's credit rating. Considerations when taking a loan include interest charges on the loan amount, potential taxes, reduced cash value and reduced death benefit.

Understanding loan charges and credits

When customers take a policy loan, the loan amount is charged a fixed rate of interest and is also credited interest at a fixed rate. The amount of interest is generally based on the type of loan. There are two types of loans:

- **Preferred loans** – Any loans up to the gain in the policy (after surrender charges)
- **Standard loans** – Any loans against the premiums paid

Typically, all loans will become preferred after the surrender charge period. Preferred loans are generally charged a lower rate than standard loans.

Example: A policy charges a loan interest rate of 2 percent on preferred loans and 3 percent on standard loans. It also credits 2 percent interest to all loaned amounts. Therefore, the net interest charged is 0 percent on preferred loans and 1 percent on standard loans.

Comparing variable and fixed loans

A newer style of loan is the variable loan. It may also be referred to as an alternative loan or participating loan. Whereas fixed loans credit a predetermined interest rate, variable loans credit a rate that fluctuates based on a market index or the policy's investment options. The difference between the credited rate and the interest rate charged is what is applied to the policy.

The advantage of a variable loan is the potential to continue earning policy interest on the amount that has been taken as a loan. The disadvantage is that this option is more volatile than the fixed loan option. The interest rate credited and the interest rate charged can vary greatly, resulting in more risk than with a fixed loan. If the policy performance is lower than projected, a customer may need to pay additional premiums or make loan interest payments in order to keep the policy from lapsing.

TIP: By paying loan interest annually, a customer will help prevent the loan from increasing and potentially causing the policy to lapse.

Rescuing a loan

A policy that lapses due to an outstanding loan could result in significant tax liability. If unaware, a customer may be surprised when the tax bill arrives. Four basic options can be considered if one of your customers owns a policy that is projected to lapse:

- **Allow the policy to lapse** – Once it lapses, the policy owner must include as income the portion of the loan that exceeds the cost basis. This amount will then be taxable.
- **Surrender the policy** – This option allows premium payments to stop immediately. Just as with a lapse, however, any portion of the loan and any cash received that exceeds the cost basis must be included as income and taxed accordingly.
- **Complete a 1035 exchange to a new policy and extinguish the loan** – Without the loan carrying over, the policy owner will be taxed on any gain in the contract up to the amount of the loan.
- **Complete a 1035 exchange to a new policy with the loan** – In this situation, the loan is preserved on the new policy and no taxable event has occurred. Not all companies allow a 1035 exchange with a loan, so you must check with the receiving company before requesting a 1035 exchange which includes a loan.

TIP: When deciding which loan rescue option is the best for your customer, be sure to consider how each possibility will affect the death benefit and cash value as well as taxes.

Provisions and Exclusions

Every policy has a set of provisions and exclusions. Before helping customers purchase life insurance coverage, it is vital that you make sure they understand these concepts and limitations.

Some provisions and exclusions to be aware of include:

- **Misstatement of age and/or gender.** This provision protects the insurance company from an incorrect entry of age or gender that could affect the policy benefits. These two factors are typically listed due to the impact they can have on the size of the premium payment. Often, the company will recalculate premiums based on the correct information and deduct that from what is paid to the beneficiaries.
- **Suicide.** This can be found in almost any insurance policy. If the insured dies as a result of suicide within two years of the policy issue date, beneficiaries are not eligible to receive the death benefit. In many cases, however, beneficiaries would receive an amount equal to premiums paid.
- **Incontestability clause.** This provision provides a layer of protection for policy owners, preventing the insurance company from contesting the policy or the waiver of premium clause after the policy has been in force for a specified period of time. Generally, the only exceptions to this are fraud, missed premium payments, or a misstatement of age or gender.
- **Premium provisions.** Every policy needs to specify premium payment methods, premium due dates and any applicable grace periods.

Taxation of Life Insurance

Life insurance can offer considerable tax advantages, but there are a number of rules that come along with these benefits. It's important to be aware of all the taxation-related considerations tied to these insurance products.

Tax Rules as They Apply to Life Insurance

Four primary tax rules govern life insurance:

- The death benefit typically transfers to beneficiaries free of income tax
- The cash value of the policy is allowed to grow tax-deferred
- Loans are generally received tax-free (unless the policy is a modified endowment contract, lapses or is surrendered with an outstanding loan)
- Withdrawals are taxed on a first-in, first-out basis unless the policy is a modified endowment contract

To give customers the opportunity to take advantage of these benefits, however, you must ensure that each policy is classified as life insurance.

Life Insurance vs. Investment

Because of the cash value accumulation potential of many life insurance products, particularly universal life, the Internal Revenue Code (IRC) has guidelines for determining whether a policy qualifies as a life insurance policy and, if so, whether it is also a type of life insurance policy known as a modified endowment contract (MEC).

TIP: Keep in mind that this is all based on tax law, and individual insurance companies cannot offer exceptions.

Classifying as life insurance

Essentially, a policy must pass one of two sets of tests - either the guideline premium and cash value corridor tests or the cash value accumulation test - to be officially labeled as life insurance according to IRC §7702. At this point, the policy owner will enjoy the tax-deferred growth and income tax-free death benefit. If neither of the test sets is passed, both death-related tax benefits are lost and all of the gain in the cash value is currently taxable.

Guideline premium and cash value corridor tests – The guideline premium test requires that the life insurance premium payments do not exceed the greater of the guideline single premium and the sum of the guideline annual premiums.

TIP: These guideline premium amounts will be defined for you in an illustration.

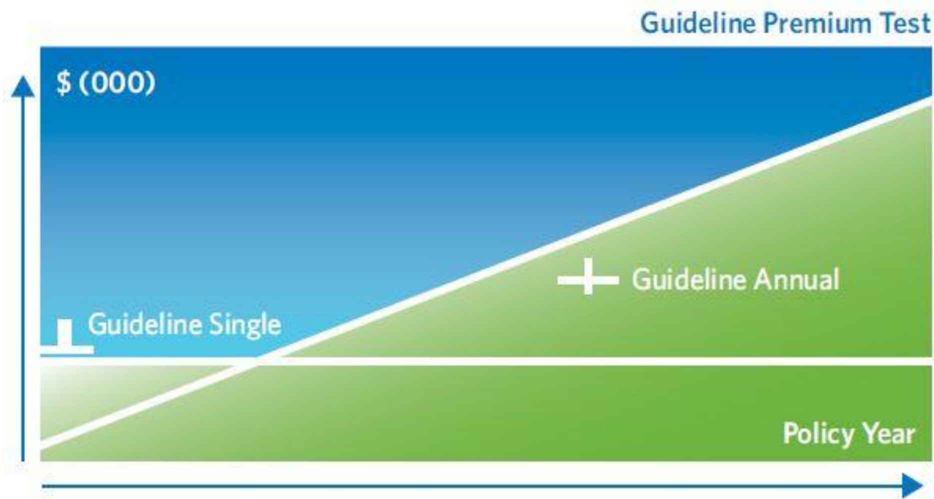


Chart is hypothetical and for illustrative purposes only.

An additional part of the guideline premium limit test is known as the *cash value corridor test*. This test ensures that a policy includes a certain amount at risk—a minimum separation between the cash value and the death benefit known as the net amount at risk (pure insurance amount). If the cash value approaches the face amount, the death benefit must increase to accommodate the net amount at risk.

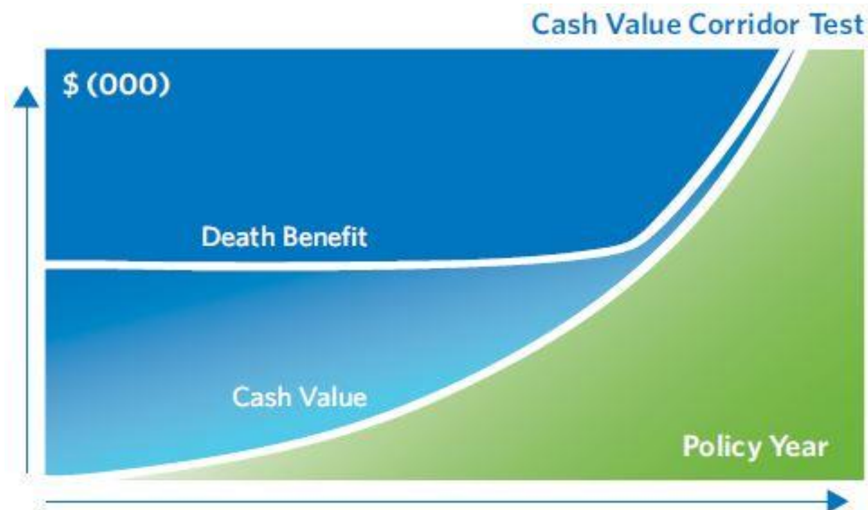


Chart is hypothetical and for illustrative purposes only.

Cash value accumulation test – To pass this test, a policy's cash surrender value cannot exceed the net single premium (required to fund future benefits). If this test is not passed, the policy will not qualify as a life insurance policy under the Internal Revenue Code.

Understanding modified endowment contracts

To help a customer maintain all the living tax benefits tied to loans and withdrawals, you need to ensure that the policy is not considered a MEC. In 1988, tax legislation known as TAMRA was enacted to discourage life insurance policies that are overly investment-oriented. To accomplish this goal, TAMRA placed limitations on the amount of funding a life insurance contract can receive (IRC §7702A). If these limits are exceeded, the policy becomes a MEC and is taxed differently than non-MEC policies.

If a policy becomes a MEC, it qualifies as a life insurance contract under §7702 but is taxed differently because it exceeds the maximum investment allowed under §7702A. While a MEC offers the benefits of tax-deferred growth and a tax-free death benefit, it doesn't allow for tax-free loans or withdrawals taxed on a first-in, first-out basis.

What does this mean for the customer? Essentially, a MEC will be taxed similarly to an annuity. All withdrawals will be taxed on a last-in, first-out basis (i.e., gain out first) at ordinary income tax rates. Distributions may carry a 10 percent penalty if taken before age 59 and all loans will be taxed the same as withdrawals.

To determine whether a policy could become a MEC, the 7-pay test was created. Essentially, premiums paid during the first seven years of the contract cannot exceed the total premiums that could pay up a policy in seven years.

TIP: The 7-pay test is not integrated into the guideline premium tests. While a certain premium may be acceptable under the 7-pay test, it may not pass the guideline premium test and could cause the policy to fail the tests that are required to qualify as life insurance. This would trigger immediate taxation on all the gain in the policy as well as income tax on some or all of the death benefit. Be sure to check your numbers with both tests.

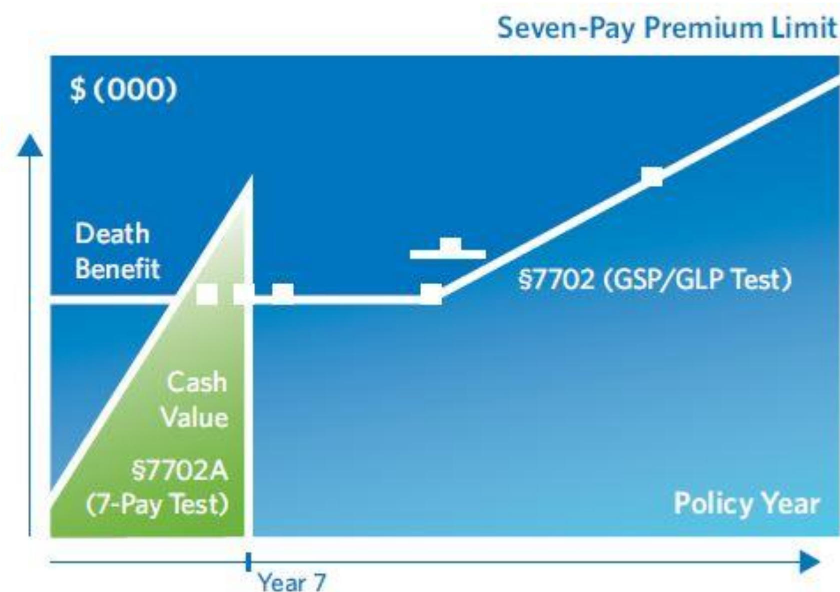


Chart is hypothetical and for illustrative purposes only.

This test is applicable for the first seven years of the policy and comes back into play for an additional seven years after a material policy change (usually increase of death benefit or addition of certain riders known as qualified additional benefits). Generally death benefit option changes will not be considered a material change. In the case of a survivorship life policy, however, the 7-pay test applies for the entire life of the contract.

Keep in mind that a MEC is not necessarily a bad thing—as long as it is intentional and both you and the policy owner understand the associated tax implications. The problems lie in a life insurance policy unintentionally transitioning to a MEC. One cause of this could be a decrease in benefits during the 7-pay test window. If there is a decrease in the death benefit, removal of a rider, or partial withdrawals that affect the 7-pay test limit, a policy can become a retroactive MEC (meaning the policy becomes a MEC as of the issue date).

Facing force-outs

If benefits are reduced at any time on a policy, there is a possibility that premiums already paid will exceed the legally permitted amount under the definition of life insurance. This excess could be forced out of the policy and returned to the policy owner to maintain its status as a life insurance contract. Should this happen, all or a portion of the forced-out amount may be taxable to the extent that there is a gain in the policy.

Reasons for a force-out include reduction of the death benefit, removal of a rider and withdrawals. Before making any of these changes to a policy, customers should consult with a tax advisor.

TIP: Be cautious when designing an illustration that involves a decrease in death benefit or a withdrawal on a policy using death benefit option 1 in the first 15 years of the policy.

Deductibility of Premiums

No tax deduction is allowed for premium payments if the taxpayer is the owner or beneficiary of the policy.

For the portion of your customer base made up of business owners providing life insurance benefits for their employees, a tax deduction may be possible. But it's important to understand the rules regarding corporate deductibility of premiums.

Business owners interested in providing life insurance benefits for employees might be able to deduct the costs of those benefits. To do so, they must ensure that they are not listed as the owner or beneficiary. There are three common strategies for doing this:

- **Bonus plan** – With this method, the company provides extra compensation to a select employee to be put toward the cost of a personal life insurance policy. The key here is that the employee must be the owner and beneficiary, and must include the amount of the bonus as taxable income.
- **Group term life plan** – An employer can provide group term life insurance that will benefit all employees. When properly structured, this group approach may generate an income tax deduction for the organization, although the deduction may not be deductible on a dollar-for-dollar basis.
- **Pension plan** – This strategy sets the pension plan up as the owner of the insurance policies on all participating employees. The employer can deduct the amount contributed to the pension plan (rather than life insurance premium payments). Keep in mind, however, that setup and implementation of a pension plan may be costly, plan participants must recognize the value of the death benefit as taxable income, and the cost of cancelling coverage after a participant retires may be high. Policies owned in pension plans are subject to premium limitations.

Common Mistakes

As you work with customers to establish and manage life insurance coverage, be sure to watch for these common mistakes that can cause the loss of a tax-free death benefit:

- **Transfer for value** – Transferring a policy for valuable consideration (i.e., money or loan forgiveness) can lead to the death benefit becoming partially or fully taxable. There are however, several exceptions to this rule, including transfer to the insured, transfer to a partner of the insured, transfer to a partnership in which a partner is the insured, transfer to a corporation in which the insured is a shareholder, or a gift situation in which the transfer is completely without consideration.
- **Employer-owned life insurance** – With a policy that is owned by an employer to insure an employee, specific notice and consent requirements must be met and the employee must be a highly compensated individual. If not, any portion of the death benefit that exceeds the premiums paid is considered taxable income for the employer. The IRS also requires annual reporting of employer-owned contracts for each year the contract is owned.
- **C corporations** – If an employer-owned policy is owned by a C corporation, the death benefit and cash values may be subject to an alternative minimum tax (AMT).

1035 Exchanges

IRC §1035 allows policy owners to make a change from one type of policy to another on a tax-free basis. These changes are referred to as 1035 exchanges, and they can be beneficial for certain customers.

IRC §1035 permits a taxpayer to exchange one life insurance policy for another that better suits his or her insurance needs. A properly structured 1035 exchange will not trigger income tax on the gain in the surrendered policy, will carry over the tax basis and can minimize the risk of the policy becoming a modified endowment contract.

Requirements for a 1035 Exchange

A successful 1035 exchange involving life insurance must meet a specific set of requirements:

- The policy owner must remain the same.
- The insured must remain the same (The only exception to this rule is if the first insured on a survivorship life policy has passed away).
- The current policy must be exchanged for the same type of policy or one with a less favorable tax benefit. Allowable options for life insurance include:
    - Life insurance → life insurance
    - Life insurance → endowment
    - Life insurance → annuity
    - Life insurance → qualified long-term care coverage

TIP: Exchanges from an annuity to life insurance or an endowment to life insurance are NOT allowed under §1035.

Impacts of a 1035 Exchange

A 1035 exchange will impact a life insurance policy in the following ways:

- The new policy must meet the IRC §7702 limits (the guideline premium and cash value corridor tests or the cash value accumulation test).
- An exchange is considered a material change and will start a new 7-pay test window. The 7-pay limit on the new policy will generally be lower than the limit which may have existed on the old policy.
- Pre-TAMRA policies that are exchanged will lose their grandfathered status and will need to meet all TAMRA regulations.
- When a policy loan is involved in a 1035 exchange, extinguishing the loan could create taxable income. When not extinguishing the loan, ongoing loan interest costs will result.

Policy Structure

When working with a customer to establish life insurance coverage, it is important to focus on properly structuring the policy. Help individuals carefully consider whom the policy owner and beneficiaries will be to avoid issues down the road.

Ownership

The policy owner is the individual or entity who owns the life insurance policy and has contractual rights. Keep the following in mind as you determine policy ownership with your customers:

- The policy owner does not need to be the insured individual or even the one who makes the premium payments. Keep in mind however, that many companies will evaluate policies with third-party payors more stringently at issue.
- Multiple policy owners can be named, but they all must act jointly on each policy transaction and all of their signatures are required for any change in the policy. When naming multiple policy owners, keep in mind that there may be gift and/or estate tax issues that should be considered.
- It is wise to name a contingent owner if the policy owner is an individual who is not the insured. If the policy owner should die before the insured, ownership would be passed to the contingent owner.
- You should not name a minor as an owner. When a minor is intended to be the owner, it may be a good idea to consider a custodial account - i.e., a Uniform Gift to Minors Act (UGMA) or a Uniform Transfers to Minors Act (UTMA) account. These accounts are controlled by the custodian until the minor is the age of majority (for an UGMA account) or a specified older age (for an UTMA account). Naming one of these accounts as the policy owner is done using the following wording: John

Doe as Custodian for Jane Doe, minor, under the (state) Uniform Gift to Minors Act -or- John Doe as Custodian for Jane Doe, minor, under the (state) Uniform Transfers to Minors Act.

- If three separate parties make up the policy owner, the insured, and the beneficiary of a life insurance policy, significant tax problems could exist. The death benefit is considered to be a lifetime gift from the owner to the beneficiary, resulting in the death benefit being subject to a gift tax. To help avoid this problem, the insured and owner should be the same or the owner and the beneficiary should be the same. If a business is the owner, the death benefit will most likely be treated as income to the beneficiary (and in certain circumstances the business) and subject to income tax rather than gift tax. To help avoid this problem, a business owner may want to consider structuring the arrangement as an executive bonus plan or an endorsement split dollar plan.
- If an employer is to be listed as the policy owner, specific employee notice and consent requirements must be met before the coverage is established and certain exceptions must apply in order for the death benefit to be income tax-free.
- Customers whose estates will most likely exceed the federal exclusion amount may face estate taxes on the death benefit if they are both the policy owner and the insured. If these individuals never own the policy and never have any incidents of ownership, the death benefit cannot be included in the estate.
- Stranger-owned life insurance (STOLI) policies are not allowed by a majority of insurance companies. STOLI is insurance that is purchased with the intent of selling the policy to an investor or investors who do not have insurable interest in the life of the insured. This allows the investor to collect the death benefit and make a profit upon the death of the insured.

Beneficiaries

A beneficiary is an individual, trust or business listed on the policy to receive the death benefit payment when the insured dies. Every policy should have designated beneficiaries, but the beneficiaries can usually be changed at any time during the life of the insured. And, if multiple beneficiaries are designated, the policy owner can determine whether the death benefit is divided evenly or by specific percentages.

In general, beneficiaries can be broken into four categories: primary, contingent, revocable and irrevocable. A primary beneficiary is the person named to receive the death benefit. A contingent beneficiary is an alternate who will receive all or a portion of the death benefit if the primary beneficiary dies prior to the insured, preventing the payout from being paid to the estate. A revocable beneficiary can be changed at any time by the policy owner. An irrevocable beneficiary can be changed at any time, but the beneficiary must provide consent.

TIP: It is often recommended to follow the “rule of two” when it comes to beneficiaries. For every primary beneficiary listed, two contingent beneficiaries are designated.

If multiple beneficiaries are listed, they can be named either per capita or per stirpes. If named per capita, when one beneficiary dies, the death benefit will typically be split equally among the remaining beneficiaries. When named per stirpes, the benefits are divided among living beneficiaries and the descendants of deceased members.

When helping your customers establish beneficiaries, it’s important to avoid these common mistakes:

- Naming the estate as the beneficiary. This could lead to the death benefit being needlessly subjected to probate and the owner’s creditors’ claims.
- Not listing a contingent beneficiary. Without this backup, the estate could become the beneficiary if the primary beneficiary dies before or at the same time as the insured.
- Naming a minor as the beneficiary or contingent beneficiary. In most states, children are not entitled to receive insurance proceeds until the age set by state law. This can cause problems when a couple names each other as primary beneficiary and their children as contingent beneficiaries.

TIP: To avoid this, a trust is often established as the beneficiary of the life insurance policy. A Uniform Transfers to Minors Act (UTMA) account can also be established to allow the proceeds to be controlled by a custodian until the minor is a specified older age.

- Listing beneficiary allocations as amounts instead of percentages. When allocations are written as amounts, if the death benefit is changed in the future or is reduced due to loans or withdrawals, it may become unclear how the owner intended to split the benefits.

Policy Illustrations

Insurance illustrations are given to customers to help them understand a policy. These are some of the most powerful sales tools an agent has. They show customers how the policy could work for their personal situation.

Running term illustrations

For term life insurance policies, the illustration is fairly straightforward. It shows the maximum premium amount, the death benefit amount, the number of years and a list of additional riders the customer is purchasing. A term life insurance illustration is helpful for the customer but not required.

Running universal life illustrations

For universal life insurance products, illustrations typically show both guaranteed and projected values (a.k.a. current values). The guaranteed assumptions are the worst-case scenario. These values reflect the lowest interest rate that can be credited to the policy and the highest charges that can be deducted from the policy. The projected values generally reflect the charges being deducted and the interest rates being credited as of the day the illustration is prepared. The actual policy could perform better or worse than the projected values. A universal life illustration that does not follow the NAIC illustration regulations is generally referred to as a quote instead of an illustration.

Universal life insurance illustrations will also allow you to illustrate the purchase of additional riders and features. Most will allow you to show the impact of future premium and death benefit changes as well.

With universal life insurance, an illustration must be provided to customers in states that have approved the NAIC model illustration regulations. Customers must sign the illustration and send it to the insurance company prior to the policy being issued. They can also sign a disclosure stating that a copy of the illustration will be provided at the time of policy issue. (The exception to this is when an insurer has made the decision to market a product without an illustration.) If the policy is approved other than as applied for, a revised illustration will be provided to customers when they receive their contract.

Running whole life illustrations

For whole life insurance policies, an illustration will generally be available. However, it is not typically required as long as the policy is fully guaranteed. If a whole life insurance policy has elements that are nonguaranteed, then an illustration must be provided and follow the same illustration rules as universal life insurance products.

WinFlex Web

Each company has its own software that allows you to run illustrations. There are also third-party aggregators that help you run illustrations from multiple carriers all in one place. One of the most common aggregators is WinFlex.

By handling multiple insurance carriers, WinFlex makes it simple for you to run comparisons. You can register at WinFlexWeb.com.

Policy Comparisons

You can use illustration software to easily compare policy options. This will give customers a clear picture of the differences and similarities of two different products and aid in ensuring that the best coverage is selected. Two of the most common comparisons are a comparison of premiums and a comparison of cash values; however, these two comparisons should not be made in isolation.

Annual Cost of Funding

One potential for comparison is to investigate the annual cost of funding. This calculation involves the following formula:

$$\frac{\textbf{Total Premiums Paid – Surrender Value}}{\textbf{Number of Years of Coverage}} = \textbf{Annual Cost of Funding}$$

By running a cost of funding calculation, you can show customers how a policy with a higher cash surrender value can make up for slightly higher up-front premiums. This calculation is especially important if a customer decides the policy is no longer needed or that a different type of policy would be more beneficial in the future. Certain states may not allow this calculation to be used as a comparison since this simplified calculation does not take into account the time value of money.

Internal Rate of Return

Another way to compare a customer's options is to determine an internal rate of return (IRR). The IRR is the annual return a policy owner would receive on their total premium payments, less distributions, if the policy is surrendered or the insured dies in a given year. This illustration calculation can show a projected growth for each policy over the course of a certain number of years.

Insurance Company Comparisons

Beyond comparing benefits of individual policies, you also need to compare the insurance companies providing these policies. The coverage is only as good as the company's ability to follow through on benefits in the future. Therefore, it's important to know a company's rating before suggesting its products to customers.

Companies are rated by a variety of independent insurance ratings companies, two of the more well-known being A.M. Best Company and Standard and Poor's Insurance Rating Services. Each ratings company comes with its own strengths and weaknesses as well as its own specific rating process. As a whole, however, all of them examine financial strength, assess long-term stability and judge the overall reliability of insurance companies. To find a company's rating, you can visit its website or go directly to the rating company's website.

TIP: Become familiar with the ratings system of each ratings company you reference. An "A+" rating from one organization could mean something very different than the same rating from another

Future Changes

Since life is constantly changing, so will your customers' life insurance needs. Marriage, divorce, children, medical issues, emergencies—all of these things can alter the type or amount of coverage an individual may require. And, new insurance products hit the marketplace regularly. You need to make sure your customers' life insurance policies are keeping up.

Policy Reviews

Because of all of these variables, it's important to conduct regular policy reviews with each couple or individual you serve. Schedule a regular meeting every year or two to discuss changes that have happened or will happen in the near future.

You will want to go over a customer's current situation and give an assessment of whether you believe existing coverage is adequate. Then review the current policy's features and associated costs. You should make sure the beneficiaries listed on the current policy are accurate as well.

By doing this, you can help ensure that every customer's life insurance is keeping up with life. It will also help strengthen the working relationship you maintain with each of your customers.

Re-projections

As part of a policy review, you may want to run an in-force re-projection. This updated version of the illustration can provide you and your customer with a clearer picture of whether or not specific life insurance coverage is still meeting important needs. Companies are required to provide customers with re-projections upon request after the policy has been inforce for one year.

Lapsed Policy Reinstatement

Some customers may inadvertently allow a life insurance policy to lapse - either due to a missed renewal date on term life, a missed premium payment when there is no cash value in the policy to cover the payment, or the presence of a large policy loan. Reinstating a policy that has lapsed can be done in many circumstances.

Most policies can be reinstated within five years of the lapse by paying required back premiums due and confirming that the insured individual is still insurable at the same rate class. A policy generally cannot, however, be reinstated if the insured individual has become uninsurable or if the policy was actively surrendered. If a contract has lapsed during the 7-pay period and then is reinstated more than 90 days after the lapse, the policy will automatically become a retroactive modified endowment contract. If a policy lapses with a loan, it will trigger income taxation if the loan is in excess of the cost basis. Reinstating the policy after 90 days does not erase the taxation.

Coverage Cancellation

With permanent insurance coverage - such as whole life, fixed universal life and variable universal life, you may need to help a customer cancel a policy at some point. Each individual product will have its own specifics regarding this, but as a whole, the policy owner will receive all cash value that has accumulated (known as the surrender value) minus any applicable surrender charges.

Claims and Settlement Options

You will need to work with beneficiaries to file a life insurance policy claim when one of your customers passes away. After family members contact you, help them understand the coverage that is in place, fill out the necessary paperwork and ask them for a certified copy of the death certificate for the insurance company. Then you can submit the claim.

During this process, the beneficiaries will need to determine how the death benefit is to be paid out if payout wasn't stipulated in the policy. There are a variety of settlement options to consider, such as:

- **Lump sum payment** – This is the most common type, with the beneficiaries receiving the entire death benefit payment at the time the claim is filed.
- **Fixed period** – In this option, payments are spread out over a period of years. Any portion of the payment not yet distributed will generate interest.
- **Period certain and life** – These periodic payments are designed to budget the funds while maintaining an investment. Funds cannot be withdrawn outside of the specified payments, but those payments will be guaranteed for a specific amount of time or for the life of the beneficiary— whichever is longer.

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