Introduction

The Kentucky Department of Insurance is pleased to offer this "Life Insurance Buyer's Guide" as an aid to assist you in determining your insurance needs and the products that will fill those needs. This guide contains only a brief description of various life insurance products. For specific information about a particular type of life insurance product, you should consult an agent. This guide is not meant to offer legal, financial or tax advice. You may want to consult independent advisors for those specific questions. This guide does not endorse any company, agent or policy type.

What is Life Insurance?

Insurance, by its nature, is a way of pooling risks. Everyone in the pool pays insurance premiums while hoping he will not need to collect. The company bears the risk, hoping that the amount of the premiums paid will cover any losses incurred.

In the case of life insurance, your life is the risk. The insurance company offers a policy to an individual after carefully weighing the likelihood he will die while the contract is in force.

Lifespan is an important question to the company that insures you. For example, most life insurance companies assume that everyone will die by the age of 100. Because some people are living longer today, there are companies that go to age 121. In addition, to maintain financial solvency, a company must consider how much premium it must collect before it pays out a death benefit. With that in mind, if you buy a life insurance policy when you are 25 years old, you will pay a lower premium for the same policy than a 65-year-old because you will pay the premium for a longer period of time. The 65-year-old will pay more because there are fewer years for the company to collect premium before the person reaches 100.

An insurance company agrees to pay your beneficiary a specific amount of money when you die. That amount is determined when you apply for life insurance and is specified in the policy you buy. Anyone can be named beneficiary including relatives, friends, organizations, charities, business partners, etc. Generally, you will name a primary and secondary beneficiary. The secondary beneficiary will receive the death benefit only if the primary beneficiary is no longer living at the time of your death.

You pay for the policy by making premium payments. There are numerous payment plans available including monthly, quarterly, semi-annually or annually. You also may pay the entire premium in one lump sum, also known as single premium. The amount of premium you pay depends on a number of factors such as age, gender, health, whether you are a smoker or a non-smoker, how much insurance you are purchasing, type of policy you are purchasing, and your lifestyle, such as if you participate in risky activities like race car driving or hang gliding.

Why You May Need Life Insurance

Paying for funeral and burial expenses can be a heavy financial burden. If the person who dies is the primary wage earner for the household, it may be difficult for those left behind to pay the mortgage, utilities, car loans, food and any other expenses. It could be very difficult to maintain the family's same standard of living without that income. Life insurance can make sure your family is not burdened with the debt left behind and can ease the financial hardship associated with the death.

Purchasing life insurance should be considered when you are starting a family, getting married, planning for your children's education, or planning for retirement. These are just a few examples.

Families with young children may have a need for life insurance. If there is a loss of income in the family, the family's future plans may be compromised. A child who will be ready to go to college in a few years may not be able to go. There could be additional expenses, such as childcare, if the surviving spouse has to take on additional work to support the family. Without sufficient income available to the family, other things will have to be considered as well. If you died, would your family be able to afford the house in the community you live in now? Would your children be able to go to the same schools? A life insurance policy can do more than just replace lost income. It also can provide money for unexpected expenses that may arise in the future.

In order to get the best life insurance policy for your family, you need to know what is available to you. It is very important to do some research before you buy a life insurance policy. This does not have to be a long, drawn-out process. However, it is wise to research companies and products to find one that fits your personal situation.

Call local insurance agents and set up appointments to speak with them about the products they offer. They will often fill out a "worksheet" with you to determine how much and what types of insurance best suit your needs. Do your own research on the Internet. If you do not have a computer, go to your local library. Also, friends and family can be very helpful. Odds are, someone you work with, are associated with, or a family member has purchased life insurance.

Buying Life Insurance

When you buy life insurance, you want coverage that fits your needs. It makes good sense to ask a life insurance agent or company to help you. An agent can help you review your insurance needs and provide information about the available policies. If one kind of policy doesn't seem to fit your needs, ask about others. This buyer's guide provides only basic information. You can get more facts from a life insurance agent or company or from your public library. Do not purchase any life insurance product if you do not understand exactly what you are purchasing. Be aware that once you have purchased a life insurance policy, you have at least a 10-day period ("free look" period) to review the policy. If you find, for any reason, that you do not want the policy, it can be returned to the company for a full refund of premium during this free look period.

How Much Life Insurance Do You Need?

Here are some questions to ask yourself:

How much of the family income do I provide?

If I were to die prematurely, how would my survivors get by?

Does anyone else depend on me financially (parent, grandparent, brother or sister)?

Do I have children for whom I'd like to set aside money to finish their educations in the event of my death?

How will my family pay final expenses and repay debts after my death?

Do I have family members or organizations to which I would like to leave money?

Will there be estate taxes to pay after my death?

How will inflation affect future needs?

What is the right kind of life insurance for you?

Typically, life insurance fits into one of two classes - permanent insurance and term insurance. There are, however, many variations within each of these classes. The following are examples of each. This is by no means an exhaustive list, but will give you a good idea about each class.

What is Term Life Insurance?

Term life insurance provides life insurance for a limited period of time. As the name suggests, it is for a specific term, a number of years, or until the insured reaches a specified age. If the insured dies within that period, the beneficiary receives the death benefit. However, if the insured survives the specified term of the policy, the policy simply ends. Term life insurance typically has no cash value; this is the savings element that is present in some policies. Most term life policies have a level death benefit for the duration of the policy. Although the death benefit remains the same, the premiums normally increase each year. The reason for this is that the age of the person insured also is increasing; age is one of the factors that determine premium.

A couple of important features to consider when researching term insurance policies are renewability and convertibility. Almost all term policies contain the option of renewability. At the end of the term, the policy can be renewed for a limited number of additional years without a medical exam. The premium normally will increase with each renewal, which is expected, because of the insured's increasing age. Renewability may be a very important factor to an insured who has recently had a decline in health status.

If that person had to apply for new insurance after the term expired, he may find himself uninsurable and be without coverage he may need. Fortunately, he can turn to the renewability feature and will have extended coverage without a medical exam. Be aware, as the insured reaches advanced ages, the premiums can become very expensive.

Convertibility is another option on a term policy. It is the option to convert a term policy into a permanent policy without new evidence of insurability, which means no new medical exam. Convertibility is allowed on an "attained age" basis or an "original age" basis. Attained age allows you to purchase a new permanent policy at the premium rate for your current age. Original age allows you to go back to the premium rate you were charged at the age you first purchased the term policy. As you can imagine, the company will charge an additional fee for original age rates. Attained age is the most frequently used convertibility option.

Types of Term Life Insurance

Yearly renewable term – This type of term policy functions as the name suggests. It is issued for a year and the owner can renew annually for future one-year periods. With this type of policy, the insured is normally not required to take a medical exam for renewal. The insured must be allowed to renew, and the increase in premium is based on age and life expectancy.

Renewable terms for other durations – There can be term policies written for different durations, depending on what the company offers, such as 5-year term, 10-year term, etc. In each of these, the premium would remain the same for the duration of the term. The policy may be renewed at the end of the term, but the premium will change due to the age of the insured at time of renewal.

Term to 65 – Also acts as the name suggests. It provides coverage to a specified age. The premium stays level throughout the term; however, insurance expires when the term is over.

Decreasing term – The face amount, or benefit, decreases over the term of the policy, but the premium remains the same. This type of policy is most commonly used for loan or mortgage protection and can cover a variety of durations, usually 10-30 years. They are typically structured to provide enough benefit to pay off the loan if an insured dies.

Level term – Both the death benefit and the premium remain the same for the entire length of the contract.

Increasing term – Normally issued as a rider to another policy. The face amount, or benefit, increases over the term of the policy.

What is Permanent Life Insurance?

Unlike term life insurance, permanent life insurance remains in force for the full life of the insured as long as premium payments are made in accordance with the policy provisions. Typically, permanent life insurance has a cash value or account value.

Types of Permanent Life Insurance

Whole life insurance – This permanent type of life insurance is different from term insurance in that it provides coverage over the insured's lifetime, not just a portion of the insured's life. Whole life provides coverage to age 100. Since the companies charge premiums based on the assumption that most people will die by age 100, the company pays the policy face amount to those who attain age 100.

In general, premiums can be paid until age 100, or for a portion of the insured's life. Single premium whole life policies are paid with one lump sum payment. Premiums stay level throughout the policy. Since premiums are based on age, the younger a person is when the policy is purchased, the lower the premium will be throughout the life of the policy. In addition to level premiums, the death benefit also remains the same.

It was mentioned earlier that premiums for whole life policies could be paid for a shorter period of time instead of being paid to age 100. This is referred to as limited payment whole life. This allows the premiums to be paid for a shorter time while the death benefit stays in force until age 100. Once the premiums are paid for the chosen period of time, the policy is paid up.

Other forms of limited pay policies are those in which the premiums are paid for a certain number of years or to a certain age. Companies will offer different options such as "Life to 65" or "20 Pay Life." The premiums would be calculated so that the insured would pay until he reaches the specified age or the specified number of years. Then the premiums would no longer be paid. If you choose to purchase one of these limited pay policies, your premiums will be higher than if you paid premiums until age 100. This is because the coverage is until age 100 but the premiums are being paid for fewer years.

A very important aspect of whole life policies is that they have a cash value. This means the policy also has a savings aspect for the insured. A portion of each premium payment goes into the cash value. The policy owner can access this money in a number of ways. Whole life policies have to contain a schedule that shows the owner the minimum value he can receive if he decides to surrender the policy. However, surrender is not the only way to access the funds. Loans can be taken out up to the cash value; however, interest is charged for this loan, which can be repaid at any time. If the policy is surrendered, the loan is deducted from the cash value. If the insured dies, the loan is deducted from the face amount.

Cash value can also come in the form of dividends from the company. A policy can be "participating" or "non-participating." If the policy does pay a dividend, it is a participating policy. If no dividend is paid, the policy is considered non-participating. Dividends may be taken as cash, used to purchase paid up insurance or can be applied to reduce a premium.

The following types of policies (variable life, universal life and variable universal life) are a bit more complicated and can be somewhat confusing. It is very important that you seek out an agent who has experience with these types of policies before you commit to a purchase.

<u>Variable life insurance (variable whole life)</u> – This is another type of permanent life insurance. However, the death benefits and cash account values are determined upon investment options. These investment options are usually in the form of mutual funds. Each company has different investment options and the policy owner is allowed to choose which types of funds to use. Most offer at least a stock fund, a bond fund, and a money market fund. Variable life insurance offers fixed premiums and a minimum death benefit. If the return on the investment options is high, then the account value of the policy will grow. Be aware that the account value can vary from year-to-year and even day-to-day based on the performance of the investments options. The performance of the investment options is not guaranteed. Remember, you as the policy owner are the person responsible for choosing the investment options - not the insurance company.

<u>Flexible premium adjustable life insurance (universal life)</u> – Universal life is a flexible premium life insurance policy that has an adjustable death benefit. This life insurance policy has an initial premium and flexible premiums afterwards. The policyholder can select the future amount and the frequency of his premium payments, within limits, and can also stop and start premium payments. It is very important to be aware of the account value in these types of policies to be sure there are always enough funds to keep the policy in force.

As premium payments are made, they accumulate within the policy at a fixed rate of interest and create an account value. This interest rate is determined by the company, changes periodically (usually each year) and cannot go below the guaranteed minimum interest rate stated in the policy. Each month, policy expenses are deducted from the account value. The difference between the premiums paid in plus the interest credited to these funds, less the policy expenses, equals the account value.

When a policy owner purchases a universal life policy he is given a choice of at least two death benefit options. These are usually referred to in the industry as Option A and Option B or Option 1 and Option 2. Remember, because this is a universal life policy, the policy owner is not locked into either option and the death benefit option can be changed at any time in accordance with the policy provisions. The death benefit can be either a specified amount or a specified amount including the cash value. It is very important that you understand each option before committing and make sure you have a knowledgeable agent to explain each option to you.

As long as the account values are sufficient, you may take out a loan for a certain percentage of your account value. You may also withdraw money permanently, or you may choose to surrender the policy for its surrender value. Be aware that if you surrender your policy in the early years, most companies impose a surrender charge. This charge is a percentage of the account value that the company will deduct from the amount you will receive. These charges vary by company. There is a schedule listed in the policy showing the surrender charge percentages. Normally they decrease over a number of years until they reach zero. Usually, if you surrender the policy in the first few years the account value could be completely eliminated.

Variable universal life – Not to over simplify, but there is one distinct difference between universal life (previously discussed) and variable universal life. The account value in a universal life policy grows at a fixed rate of return. The account value in a variable universal life policy increases (or decreases) at a variable rate. The rate of growth, or decrease of the account value is determined by the performance of your investment options. As discussed previously in the variable life insurance section, each company has different investment options from which to choose.

Survivorship life – This is another way to structure a life insurance policy. Policies structured this way also are referred to as second-to-die or last-to-die policies. Survivorship life insures two or more individuals and pays a death benefit upon the second death or the last death as there may be more than two lives insured. One of the reasons for purchasing survivorship life insurance would be to pay possible estate taxes.

Illustrations

You may be thinking of buying a policy where cash values, death benefits, dividends or premiums may vary based on events or situations the company does not guarantee (such as interest rates). If so, you may get an illustration from the agent or company that will project how the policy may perform. The illustration will show how the values that are not guaranteed will change as interest rates and other factors change. The illustration also will show you the values the company guarantees. Remember that nobody knows what will happen in the future. You should be ready to adjust your financial plans if the policy's value doesn't increase as quickly as shown in the illustration. You may be asked to sign a statement that says you understand that some of the values in the illustration are not guaranteed. If you already own a policy, ask for an "in-force" illustration periodically to see how your policy has actually performed. This is especially important if you own a universal life, variable universal life or variable life policy.

Important Things to Consider

1. Review your own insurance needs and circumstances. Choose the kind of policy that has benefits that most closely fit your needs. Ask an agent or company to help you.
2. Be sure that you can handle the premium payments. Ask about any possible increases in premium amounts and what may cause an increase.
3. Don't sign an insurance application until you review it carefully to be sure all the answers are complete and accurate.
4. Don't drop one policy and buy another without a thorough study of the new policy and the one you have now. Replacing your insurance may be costly.
5. Read your policy carefully. Ask your agent or company about anything that is not clear to you.
6. Periodically review your insurance program with your agent or company to keep up with changes in your income and your needs.
7. Do not buy a policy until you have a good understanding of how it works.

Are You Considering Dropping or Replacing an Existing Life Insurance Policy?

If you are thinking about dropping or replacing a life insurance policy, here are some things you should consider:

- If you decide to replace your policy, do not cancel your old policy until you have received the new one. You will have a minimum of 10 days to review your new policy to decide if it is what you want.
- It may be costly to replace a policy. There may be substantial surrender charges that you will incur. Remember that if you have held your existing policy long enough and no longer have to pay surrender charges, purchasing a new policy will start a new period of surrender charges.
- Consider consulting a tax advisor to see if dropping your policy could affect your income taxes.
- If you are older, or your health has changed, premiums for the new life insurance policy will most likely be higher. You will not be able to buy a new policy if you are no longer insurable.

You may have valuable rights and benefits in the policy you now have that are not in the new one.
If the life insurance policy you have now no longer meets your needs, you may not have to replace it. You might be able to adjust your existing policy or purchase additional insurance to get the coverage or benefits you now want or need.
Be aware that the new policy you are considering may pay only a reduced benefit in the early years for some causes of death already covered in the policy you have now.
In all cases, if you are thinking of buying a new policy to replace your existing one, check with the agent or company that issued your existing policy. Before replacing, ask your agent or company for an updated illustration (in-force illustration). Check to see how the policy has performed and what you should expect in the future based on the guarantees.

How Can You Find Missing Policies or Contracts?

If the deceased's estate went through probate, there is a chance that the policy might have been listed as an asset.

Begin by contacting insurance companies. Try to narrow your search as much as possible. For example, start with those companies most prominent where the deceased lived or worked. Contact the benefits coordinator at the deceased's place of employment. Remember, unless you are the beneficiary, the company is not required to offer any information. Try to provide as much information as possible, including the deceased's name and any aliases, Social Security number, date of birth, etc.

Ask the estate's executor to request copies of all bank statements and other records. If a check has been written or an automatic payment has been made to an insurance company, this might provide a lead.

Contact the deceased's insurance agent for homeowners, renters, or auto insurance. Although he may not have sold your friend or relative a life insurance policy, many agents keep records of their client's insurance purchases.

If you or someone in your family has a whole life insurance policy which became paid up after August 2008 but you have no records of the policy, contact the Kentucky Department of Insurance. We will need to know the name of the policyholder and a Social Security number or date of birth to check our records. You must be the policy owner, beneficiary or a person with legal authority to obtain this information.

Final Points to Consider

Remember to read your life insurance policy carefully when you receive it. Ask your agent or insurance company to explain anything you don't understand. If you have a specific complaint or can't get the answers you need from the agent or company, contact the Kentucky Department of Insurance.

Insurer Rating Organizations

Other sources of information related to the financial strengths of companies are insurance rating organizations. Some of these are A.M. Best, Fitch Ratings, Moody's Investors Service, Standard and Poor's, and Weiss Ratings Inc. You can use these sources to help you research and determine which companies you would like to contact about your insurance needs. The Kentucky Department of Insurance can provide you with ratings from A.M. Best or you can contact the companies directly to get information about their ratings.

A.M. Best
www.ambest.com
Telephone: 908-439-2200

Fitch Ratings
www.fitchratings.com
Telephone: 800-893-4824

Moody's Investors Service
www.moodys.com
Telephone: 212-553-0377

Standard and Poor's
www.standardandpoors.com
Telephone: 212-438-2000

Weiss Ratings LLC
www.weissratings.com
Telephone: 877-934-7778

Other Important Terms

Accelerated Death Benefits – a provision in an insurance policy or contract where a policy owner can receive a portion of the death benefit prior to the insured's death if the insured's life expectancy is reduced by a qualifying event. When the insured dies the remainder of the death benefit is paid to the beneficiary.

Accidental Death and Dismemberment - a form of accident insurance that pays a stated benefit to a beneficiary in the event of bodily injury or death due to accidental means. This type of coverage can be purchased as a rider or as a separate policy.

Amendment, Endorsement or Rider – forms that are used to effect policy changes requested by an owner to an individual life insurance policy.

Assignment – a provision that allows the transfer of rights under an insurance policy to another person or business. For example, to secure a debt, it is not uncommon for the policy owner to transfer to the creditor his rights to borrow on the cash value of the life policy.

Conditional Receipt – evidence of a temporary contract obligating a life insurance company to provide coverage as long as a premium accompanies an acceptable application. This gives the company time to process the application and to issue or refuse a policy, as the case may be. If the applicant were to die before a policy is issued, the company will pay the death benefit if the policy would have been issued.

Conversion Privilege – the right of a certificate holder to convert group life coverage to an individual life insurance policy without requiring a physical examination or evidence of insurability. Some individual term life insurance policies can be converted to individual whole life policies at the insured's attained age, with no physical examination required.

Critical Illness – insurance which can be purchased as a separate policy or as a rider which pays a lump sum if the insured is diagnosed with a critical illness such as, but not limited to stroke, heart attack, or cancer.

Death Benefit Options – Death benefits are normally paid in a lump sum to the beneficiary for an amount designated in the policy. Some policies, such as universal life policies, have different death benefit options referred to as Option A or Option B. One option pays the death benefit specified in the policy and the other will include the account value with the death benefit for an additional cost.

Grace Period – period after the date the premium is due during which the premium can be paid with no interest charged, the policy remaining in force. If the insured dies during this period, the beneficiary would receive the full face amount of the policy minus the premium owed.

Incontestable Clause – section in a life insurance policy stating that after the policy is in force two years, the company cannot void it because of misrepresentations or concealment by the insured in obtaining the policy.

Life Settlements - a contract entered into between a life settlement provider and an insurance policy owner where the insurance policy is sold to the life settlement provider for an amount paid to the insurance policy owner.

Long-Term Care Benefit Riders – a benefit added to a life insurance policy for an extra premium which pays for long-term care expenses.

Nonforfeiture Provisions - values in some life insurance policies that give four options which are as follows:

> **Cash Value** – a value in a life insurance policy from which a policy owner may borrow.
>
> **Cash Surrender Value** – money that has accumulated in a life insurance policy that is payable to the policy owner in a lump sum upon termination of the policy.
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> **Extended Term Insurance** – an option that uses the cash value of a life policy as a single premium to purchase term life insurance in the amount of the original policy. The length of the term policy depends on (1) the size of the cash value and (2) the attained age of the insured.
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> **Reduced Paid-Up Insurance** –an option providing for continuation of the original insurance plan but for a reduced face amount as determined by the cash value in the policy and will no longer require premium payments.

Preneed – life insurance which is purchased to pay the costs of funeral services. It is normally purchased along with a contract for the specific funeral services in order to guarantee some of the future costs of the funeral.

Rider – an additional policy provision added to a policy, usually at issue and usually for additional premium, to enhance or modify the benefits. These riders include but are not limited to waiver of premium, AD&D, spouse insurance, children's insurance, guaranteed insurability, etc.

Stranger Originated Life Insurance (STOLI) – an illegal practice where a person contracts to buy a life insurance policy with the intention of selling the policy after the completion of the two year-incontestability period.

Tax-Free Exchange (1035 Exchange) –Section 1035 of the Internal Revenue Code allows for the exchange of one life insurance policy for another life insurance policy and generally will not result in a recognized gain for the purposes of federal income tax purposes to the policy owner. The owner and the insured must be the same on both policies. Life policies can be exchanged for life policies, life policies can be exchanged for annuities, and annuities can be exchanged for annuities. Annuities cannot be exchanged for life policies.

Ten Day Free Look (basic definition) – a policy provision notifying purchasers of new insurance that they have ten days after delivery to inspect the policy or contract and if not satisfied, return it to the agent or company for a full refund of all premiums paid.

Viatical Settlements - the same as a life settlement except that the insurance policy owner has a life expectancy of 24 months or less.

Waiver of Premium – a provision that waives future premiums when the insured has become disabled for at least six months and the policy remains in force.

Waiver of Monthly Deduction Benefit – a benefit found in an individual universal or variable life insurance policy which waives the future cost of insurance payments. This benefit does not waive the entire premium. Therefore the cash values do not continue to grow as they would if the premiums were still being paid in full.