



LIFE ONLY 2009 Supplement

Copyright © 2008 D&H Investment Trust

The California Department of Insurance introduced substantial changes to its prelicense course objectives on November 3, 2008. This supplement highlights these changes.

IMPORTANT: EXPECT NEW QUESTIONS ON THE STATE LICENSE EXAM STARTING JANUARY 2009. THIS SUPPLEMENT WILL HELP PREPARE YOU. STUDY THIS SUPPLEMENT WITH CARE.

This publication is designed to provide authoritative information in regard to the subject matter covered. It is sold with the understanding that the author is not engaged in rendering legal, accounting or other professional services. The information within these pages is general insurance education. It is not to be used to advise your clients or others in specific matters unless we agree in writing, in advance, that it will be used for that purpose. If you need advice for specific client matters, seek a competent professional.

*For more course offerings
call (800) 498-5100 or go to:*

www.AffordableEducators.com

Affordable Educators.Com
41890 Enterprise Cir So #100
Temecula, Ca 92590

CONTENTS

Insurance Law	3
Licensing	5
Privacy Legislation	8
State Guaranty Associations	10
Need for Life Insurance	10
Business Life Insurance	11
Types of life Policies	11
Life Insurance Contracts	12
Life Policy Provisions	15
Policy Exclusions	18
Taxation	18
Employee Benefit Plans	19
Retirement Plans	19
Social Security	20
Underwriting	20
Claim Duties	22
Life & Annuity Riders	23

INSURANCE LAW

Elements of an Insurance Contract 9-14

The 4 major elements of a contract are:

Competent Parties
Legal purpose
Offer and acceptance
Consideration

An easy way to remember is **CLOC**

Fair Credit Reporting Act requirements: 4-20

Applications for life insurance may advise the applicant that a credit and/or medical information report may be requested. Following are necessary requirements before such reports can be accessed:

- The insurer has to get the applicant's consent before obtaining medical information.
- The insurer has to give the applicant written disclosure within **3** days of requesting a consumer report.
- If the insurance coverage is denied because of the consumer report, the consumer can find out what that information is, just in case it's inaccurate.

If the person receives an adverse notice report, that report has to include:

- The contact information for the consumer reporting agency
- A legal statement that the consumer reporting agency didn't have anything to do with the person getting denied for insurance
- A notice that the applicant has the right to dispute the information in the report. Upon request, the consumer reporting agency (NOT THE INSURER) will then supply the person with a free copy of the report within **60** days

Medical Information Bureau 4-19

There are many external organizations that provide insurance companies with information about those who apply for Life Insurance. The **Medical Information Bureau** is an association of several hundred life insurance companies that stores information about any person who applies for insurance. To protect privacy, MIB requirements are:

- The insurance company *must* notify the applicant in writing that they may report their findings to the MIB
- The MIB *must* have authorization from the applicant to provide information to other member insurance companies
- The individual may request *in writing* that the MIB disclose any information in their records
- The applicant *must* be made aware that an application for coverage or a claim may cause the MIB to supply any information to another member company.

Standards for Prompt, Fair and Equitable Settlements 10-17 thru 10-19

Standards for prompt, fair, and equitable settlements by insurance companies include the following:

- No insurer shall discriminate in its claims settlement practices based upon the claimant's age, race, gender, income, religion, sexual orientation, ancestry, physical disability, etc.
- Insurers must accept or deny an insured's claim as quickly as possible, and no later than **40** calendar days notify the claimant if more time is required and/or settle the claim by making a reasonable offer—insurers can't make an offer that's unfair or unreasonably low
- Insurers must pay any approved claims no later than **30** calendar days

Claimant is any person who asserts a right of recovery under a surety bond, an attorney, any person authorized by operation of law to represent the claimant.

Notice of legal action means notice of an action commenced against the insurer with respect to a claim, or notice of action against the insured received by the insurer, or notice of action against the principal under a bond, and includes any arbitration proceeding.

Proof of claim means any evidence or documentation in the possession of the insurer, whether as a result of its having been submitted by the claimant or obtained by the insurer in the course of its investigation, that provides any evidence of the claim and that reasonably supports the magnitude or the amount of the claimed loss.

LICENSING

Life Agent vs Life Analyst 10-22

Life agents acts on behalf of a life insurer and is paid by the insurer.

Life analysts (private consultant) acts on behalf and is paid by someone *other than an insurer.*

Title 18 8-27

Title 18, Section 1033-1034 legislation (1994) says that certain **prohibited persons cannot participate in the business of insurance** (selling, reinsuring or the role as an officer, director or employer of an insurer) unless they have received written consent of the Insurance Commissioner. A **prohibited person** means any person who has been convicted of a felony, dishonesty or breach of trust. **Conviction** means a finding of guilty or plea of guilty or no contest in a criminal court of the U.S. **Felony** means a crime for which the maximum punishment exceeds one year incarceration.

Dishonesty includes perjury, bribery, forgery, counterfeiting, making false statements, deception, fraud, schemes, material misrepresentation and failure to disclose material facts. **Breach of trust** means crimes of misuse, misapplication or misappropriation. The **penalty** for violating the above section is a fine of **not more than \$50,000 for each violation** OR the amount of compensation the person received for the prohibited conduct (whichever is greater) or **imprisonment for not more than 10 years or both**. **Failure to inform** the Department of Insurance of a prior felony conviction on a license application could result in a violation of this statute and /or constitute grounds for denial of an insurance license.

Agent vs. Broker vs. Solicitor 8

California law defines and insurance agent as someone authorized by an insurer to transact all forms of insurance except life insurance . . . that would be a task reserved for a life-only agent. "Insurance broker" means a person who, for compensation and on behalf of another *person*, transacts insurance other than life with, but not on behalf of, an insurer. Know that there is **NO life broker or NO health broker**. An **Insurance Solicitor** is a person employed to aid an insurance agent or insurance broker in transacting insurance other than life. There is **no life solicitor** license.

Agent Records 8-42

A life agent must keep the following records in an orderly and readily available manner for 5 years. Records must be delivered to the Commissioner within 30 days when requested:

- Original application or copy
- Premiums received for each policy
- Records of all policies sold in previous 5 years
- Commissions for each policy
- Record of any other agents involved in the transaction
- Correspondence, proposals, etc sent to the policyholder by insurer and agent
- Copies of written policy comparisons
- Outline of coverage copy

Policy Illustration Requirements 4-9

Note: Some policies are meant to be marketed without an illustration, others require it.

ALL **Policy Illustrations** must be clearly labeled 'Life Insurance Illustration' and must include:

- The name of the insurance company/provider
- The name and address of the insurance company/provider
- The name, sex, and age of the proposed insured
- The rate classification under which the illustration is based (e.g., smoker, non-smoker)
- The generic name of the policy, form number and company product name
- The initial death benefit
- Any dividend option if applicable

It is important to note that any interest rates used in an illustration cannot be higher than rates currently being offered by the insurance company. If a **Policy Illustration** is used, the insurance company must keep copies, including any revisions or updates, for at least 3 years after the policyowner terminates the policy.

When a **Policy Illustration** is to be used during any sales presentation of a Life Insurance policy, the insurance company, or it's representative, may not:

- Claim or mention that the policy is anything but a Life Insurance policy. Prohibited are claims of it being an 'investment' or a 'retirement savings account'
- Mislead or describe that any non-guaranteed elements in the policy are actually guaranteed
- Use or make reference to any **Policy Illustration** that does not comply with state laws and regulations
- Provide or show any incomplete illustrations
- Use the term 'vanishing' or 'vanishing premium', or any term that implies the policy becomes paid up or that future premiums can be paid by non-guaranteed elements
- Use a **Policy Illustration** that shows policy performance as more favorable to the policyowner than the insurance company's illustrated scale
- Use a higher interest rate to increase cash value or other non-guaranteed elements than the insurance company's underlying rate scale

Regulations concerning **Policy Illustrations** applies to all life insurance policies *except* for the following:

- Variable life insurance
- Group term life insurance
- Credit life insurance
- Individual and group annuity contracts
- Any life insurance policy with a face value of less than \$10,000

Any **Policy Illustration** used in a sales or marketing presentation must also be signed and dated by the potential insurance consumer to indicate that the illustration has been explained to them and they understand it.

Continuing Education 8-37

Life only agents require 24 hours of continuing education every renewal period (2 years). Special CE rules apply if an agent has BOTH a life and casualty licenses:

- Life-Only and/or Accident & Health PLUS Fire and Casualty Agents (less than 4 years in business) -- A minimum of **25** hours per year following the date of the original license issuance.
- Life-Only and/or Accident & Health PLUS Fire and Casualty Agents 4 or more years in business) -- A minimum of **24** hours per license period (every two years) following the date of the original license issuance.

Admitted vs, non-admitted insurer 8-14

For various reasons, you may only be able to place a client's coverage with a non-admitted insurer. A California **admitted insurer** is one that is domiciled (has a license to operate) in California. An admitted insurer is regulated by the State of California and also has the protection of the State's Guaranty Association – a fund used to protect policyholders by paying claims or guaranteeing insurance company investments much like the FDIC protects bank deposits. A **non-admitted insurer** is not subject to solvency and enforcement regulation by the State of California nor are they a member of the State Guaranty Fund. However, these types of insurers may be able to provide special types of insurance, lower rates or more flexible underwriting not provided by admitted companies.

Certificate of Authority 8-14

All insurance companies in California must have a **certificate of authority**, issued by the Commissioner, to be admitted to transact insurance. It is a **violation** to act as an insurer without a certificate of authority. A public offense punishable **by imprisonment not exceeding one year** or by **fine** not exceeding **\$100,000** or both.

File and Record Documentation 10-17

Every licensee's claim files shall be subject to examination by the Commissioner or by his or her duly appointed designees. These files shall contain all documents, notes and work papers (including copies of all correspondence) which reasonably pertain to each claim in such detail that pertinent events and the dates of the events can be reconstructed and the licensee's actions pertaining to the claim can be determined.

Duties upon Receipt of Communications 10-18

Upon receiving any written or oral inquiry from the Department of Insurance concerning a claim, every licensee shall immediately, but in no event more than twenty-one (21) calendar days of receipt of that inquiry, furnish the Department of Insurance with a complete written response based on the facts as then known by the licensee.

PRIVACY LEGISLATION 10-19

The Gramm-Leach-Bliley Act (1999) concerns consumer financial privacy and financial safeguards: **Financial Privacy** -- Requires financial institution to provide each consumer with a privacy notice explaining what information is collected about the consumer, where the information is used

and how it is protected. Any changes must be disclosed. Prohibits the sharing of nonpublic information with a non-affiliated third party unless consumers are given an opportunity to opt-out. **Financial Safeguards --** Requires financial institutions to develop a written security plan describing how the company is prepared for and plans to protect consumer nonpublic information, even if the consumer is no longer with the financial institution.

The California Financial Information Privacy Act (2003) adds to the financial privacy provisions of Gramm-Leach Bliley by requiring that consumers **opt-in** PRIOR to any sharing of nonpublic information among financial institution non-affiliates. Consumers can **opt-out** for any sharing of information among affiliates of the financial institution.

Insurance Information and Privacy Protection Act (2003) provides that personally identifiable information supplied to an insurance agent or broker in order to apply for insurance must be protected. Agents must provide consumers with a privacy Notice explaining how and with whom this information will be shared and the consumer right to **opt-out** from having personal information shared.

Health Insurance Portability and Accountability Act (HIPPA) assures that an individual's health information (medical records) by establishing national standards for health providers, billing services and health information companies. Requires covered entities to take reasonable steps to ensure confidentiality of communications, notification of record use and document privacy policies and procedures.

HIPPA also establishes protections for certain people – called HIPPA Eligible Individuals” – when they lose group health coverage. Once eligible, they are guaranteed an offer of at least two health insurance policies that do not impose pre-existing condition exclusion periods. HIPPA is silent on the charges for these policies.

To become HIPPA Eligible, one must meet the following criteria:

- 18 months of continuous credible coverage in a group health plan
- Already used up any COBRA or continuation coverage
- Not be eligible for Medicare, Medi-Cal or a group health plan.
- Must not have health insurance
- Must apply for coverage within 63 days of losing prior coverage

STATE GUARANTY FUNDS 11-12

The California Life and Health Guarantee Association guarantees any payments of benefits and continued coverage if an insurance company becomes insolvent. This association guarantees the following:

- **80%** of contractual limitations
- Up to **\$250,000** for Life insurance Death benefits
- Up to **\$100,000** for cash surrender value
- Up to **\$100,000** for the present value of annuities
- Up to **\$200,000** for Health benefits

Note: The maximum amount an individual can receive for all policies is **\$250,000**.

The maximum amount a firm or corporation can receive for all policies is **\$5 million**.

The **California Life and Health Guarantee Association** doesn't cover:

- Variable Life or Variable annuities that aren't guaranteed by the insurer
- Risks the policyholder accepted
- Any part of the policy that's reinsured
- Policies issued by a health care service contract
- Anyone that's self-funded or uninsured
- Parts of a policy subject to dividends or experience credits
- Policies issued by an insurer that doesn't have a Certificate of Authority in California
- Any coverage issued by the California Medical Insurance Pool

THE NEED FOR LIFE INSURANCE

Identifying Risk 1-12 . . . 1-14

While it is hard to put a value on a human life, in determining how much life insurance to provide, consider two approaches:

Human Life Approach = **Future earning potential**, i.e., the individual's annual income, multiplied by the number of years they will work until retirement.

Needs Approach = **How much cash is needed** for things like funeral expenses, mortgages or rent, debt reduction, education, emergencies, etc.

Risk Management 1-15

Techniques and examples to manage risk include

Avoidance – don't sky dive
Retention – build a large bank account
Sharing – inheritance, loan, etc.
Reduction – take care of your health
Transferring – buy life insurance

BUSINESS LIFE INSURANCE

Key Person Insurance = a company insures against the loss of key executives and key employees by buying life insurance for them with the company as the primary beneficiary. 5-12

Split Dollar Insurance = company insures the life of an employee and "splits" or divides the premium payments with the employee. Upon death, the employer gets that part of the death benefit equal to the cash value of the policy or the premiums paid. The insured's beneficiary receives the balance. 5-13

Buy-Sell Insurance = company insures that it's business will continue by purchasing life insurance on it's key employees, partners, etc. 3-33

TYPES OF LIFE POLICIES

Life insurance is sold to satisfy many different premium modes and needs:

Single premium life —a life policy is purchased with a single, large premium payment. The death benefit is free of income tax and inside cash value is tax-sheltered. (Typically purchased like a CD for favored income and estate taxes). 2-4

Limited pay life— higher premiums are paid for a specified period of time, e.g., I'll pay more while I'm young so I won't have any premiums after age 65. 2-3

Modified pay life – lower premiums for an initial period (3 to 5 years) then increase to a predetermined level. 2- 3

Level pay life – premiums at a constant rate regardless of age. 2-3

Fixed vs flexible pay life – a fixed premium, such as a whole life, includes a level amount for insurance and a certain amount to cash value. A flexible, like variable life, allows a certain amount to pay insurance protection while the balance going to cash value can vary. 2-13

Guaranteed initial level and maximum premium life – “interest sensitive life” where the contract begins at a fixed premium with a guaranteed minimum rate of return on cash value. Over time, interest rates and mortality charges are adjusted with a maximum premium specified. 2-7

Return of Premium Life – often sold as a rider allows premiums to be returned to insured if he lives to a certain age (more costly). 3-21

LIFE INSURANCE CONTRACTS

The Policy Title Page ... No Standard Policy

Unlike fire and casualty contracts, there are NO STANDARD LIFE POLICIES. However, information that typically appears on the policy title page, includes: the insured's name, the insurer's name, the policy number, date of issue, type of policy (whole life, term, etc) , right to examine (10 to 30 days), the face amount of insurance, the premium mode (annual, quarterly, monthly) and more. 3-2

Applications -- The agent completes the **application** as they question and converse with the applicant. The applicant is the person asking the company for insurance. Remember, *the applicant is not necessarily the individual who would be insured*. At this point, that person is known as the **proposed insured**. The insurance company will determine if the person will be insured, by the information on the **completed application**. Again, it is crucial that both the agent and the applicant fill out the application accurately and completely. The **application will become part of the legal contract of the policy** and be a physical part of the policy itself. The applicant must sign the application, stating that they have provided accurate information to the best of their knowledge. The agent must also sign the **application**. It is important to note that most **applications** contain space for additional comments from the agent during the customer interview process. 4-1

Disclosures – in addition to traditional disclosures regarding tax consequences, guarantees, etc., one might find the following special disclosures: 4-12

A Note on Policy Delivery... 3-2

When an agent and a customer complete an application for insurance, the customer pays the first full premium and receives a **conditional receipt** (in fire and casualty policies, the receipt would be a **binding receipt** that actually “binds” the policy . . . with life insurance, approval is conditional on the insured's health, application, etc). In essence, the insured has a **temporary insurance agreement** for a **temporary term** (for a specified period of time, or until the insured is approved). Once underwriting has

approved the application the insurance company will issue a policy. The means of delivery in California must be by:

- Registered or certified mail
- Personal delivery with a signed receipt
- First class mail with a signed receipt

The burden of proving delivery is on the insurer. But, if the insured has paid premiums pursuant to the contract, a policy is deemed to have been received six months after date of issuance.

- Buyers Guide – a generic document, like one recommend for use by the National Association of Insurance Commissioners. Basic terms and policy provisions are discussed in simple language.
- Supplemental illustrations – that are furnished in addition to the basic illustration that may show a different format or depict certain non-guaranteed elements.
- Cost Comparison Indexes show the cost of the benefits provided in an insurance policy and how to calculate them, e.g., how to determine death benefit.

Requirements For Insurable Interest To Exist 4-22

Policyowners – Policyowners must have an insurable interest in the insured at the time the policy is issued. A person always has an insurable interest in his own life. So, a man can buy a policy on himself and name any beneficiary (even pets). But to be a policyowner on another life, there must be insurable interest by blood or law, e.g., husbands and wives, parents and children, brothers and sisters, business partners, creditors, etc. . . . all can be policyowners.

Beneficiaries – At the time a policy is issued, a designated beneficiary (someone named by the owner) has an insurable interest in the policy by the sheer fact he is named. However, for someone to purchase a policy on the life of another and be named as a beneficiary, there must be insurable interest with the insured by blood or law.

Facility of Payment – a relative or any other person that incurred expenses on behalf of an insured could have insurable interest and be paid by an insurer, e.g., a non-family person paid for all of the insured's funeral expenses.

Settlement Options 3-27

It is common for most Life Insurance policies to pay out policy proceeds in a *lump sum*, one cash payment to the beneficiary of the policy. But there are other payment options available that may better fit a beneficiary's needs.

Life Income -- As the name of this option implies, this provides a lifelong income for the beneficiary. These payments are similar to annuities. A **Lifetime Income Option** will pay the beneficiary a guaranteed income for as long as they live.

Interest Only -- with this option, the life insurance company retains the proceeds of the policy and invests them, then pays out the interest earned on the principal as an income. The beneficiary may retain the right to withdraw the full amount at any time, or it can be arranged so that the beneficiary cannot withdraw the full amount until a certain amount of time has passed, or reaches a certain age.

Fixed Period Options -- The **Fixed Period Option** pays the beneficiary a guaranteed amount, based on the principal and its interest earnings, for a certain time such as over five years, or over ten years. The amount of the payment depends on the principal amount, the length of time these payments are to be made, and the interest earned. Like the previous options, if the *primary beneficiary* should die, then the payments may be made to a *secondary beneficiary*.

Fixed Amount options -- Under the **Fixed Amount Option**, the beneficiary chooses the amount of the income desired. Payments at that amount will continue until the combined principal and interest is exhausted. Again, these payments depend on the original principal, interest, and the amount of each specified payment.

Policy Dividends 3-26

Participating life companies pay dividends to certain policyholders. Dividends occur if the company experienced a lower mortality and operating expenses than originally predicted. The following are ways policyowners can elect to receive Dividend payments:

Cash Dividend Option -- This is the option in which the policyowner receives a check for the **Dividend** amount from the insurance company.

Reduced Premium Option -- Rather than receive a check, this option allows the policyowner to apply **Dividends** towards reducing the amount of their next premium payment.

Accumulate at Interest Option -- This allows a policyowner to leave their dividend payments with the insurance company to accumulate and earn interest. If the insured dies with accumulated **Dividends**, then they are paid to the policy's beneficiaries, *including* the interest that accrued on the investment. **It is important to note that the interest (not the dividend itself) is taxable.**

Paidup Additions Option -- Policyowners can use **Dividend** payments to **purchase additional life insurance**. The amount is based on the **Dividend** payment and the insured's age at the time they purchase the additional coverage. The additional amount of insurance is the same type as the original policy and does not require proof of insurability.

1 Year Term Option -- This option allows the policyowner to use **Dividend** payments to buy term insurance. This additional coverage would be in effect for one full year.

LIFE POLICY PROVISIONS

Insuring clause -- This is the basic statement of the policy that states the insurance company will pay the **specified face amount of the policy**, that is, the maximum **limit of liability**, upon the death of the insured, to the beneficiary stated in the policy. 3-2

Free look – all life policies and annuity contracts are required to have provisions that allow the insured to cancel the policy for whatever reason. This “free-look” period must be no less than 10 days nor more than 30 days and all premiums must be refunded. In the case of variable life investment contracts, the policyholder is entitled to a full refund of his account value (could be less than the initial investment if mutual funds drop) and any policy fees within 30 days. 3-3

Senior free look – all life and annuity contracts sold to senior citizens (age 60 and older) shall have a free look period of not less than 30 days. 3-3

Consideration clause -- The consideration is the **premium** paid by the insured to the insurance company in exchange for the insurance coverage within the policy. 3-2

Absolute assignment – Today, policies are sometimes “**sold**” at a **discounted value** which may be from 50 to 80 percent of the actual death benefit . . . it's called a viatical settlement. With an **Absolute Assignment**, the viatical settlement company becomes the new owner, premium payor, and beneficiary. 3-16

Stranger Oriented Life Insurance (STOLI) -- refers to a recent trend whereby older individuals (65 to 85 years of age), who are not facing current health concerns, buy life insurance policies with the specific intention to sell them to a third party, immediately or in the future. The buyer pays a discount and becomes the new owner of the policy, paying all premiums and collecting death benefits when the insured dies. 3-17

Policy changes – Policyowners have many options during the course of owning their life policies, such as changing the payment mode from annual to monthly, changing beneficiaries, converting the policy from term to whole life, loans against cash value, using dividends (if any) from the policy to pay premiums, changing from an employer-paid policy to one that is self-funded, etc. 3-3

Costly surrender charges – Be aware of and advise your clients that many life policies have very costly surrender charges. If a policyowner wishes to cancel outside of the free look period, surrender charges could reduce cash values or completely eliminate them. Example: Paul purchased a universal with high annual premiums. Paul continued to receive statements showing a cash value of \$55,000. Upon further inspection, however, the surrender value for the first 5 years was \$0, i.e., if Paul cancelled the policy during the first 5 years he would receive NO cash value despite his payment of expensive premiums. 3-2

Eligible beneficiaries – many can be named in an insurance policy:
Primary beneficiary -- the person or persons named as first beneficiary, and/or a **contingent** or second beneficiary. A contingent beneficiary will only receive the proceeds if they survive the **primary beneficiary**. 3-4

Common disaster clause -- a beneficiary must be living after a specified length of time following the death of the insured. Ensures that the *contingent beneficiary* receives the policy's benefit pay out if both the *insured* and the *primary beneficiary* die within this period of time. 3-6

Spendthrift clause -- allows the policyowner to protect policy proceeds and cash values by preventing the beneficiary from transferring or borrowing money against the policy or taking a lump sum upon death. Other arrangements, such as a trust, would specify how payments would be made and be protected from creditors. 3-9

Revocable vs, irrevocable beneficiaries -- the beneficiaries for most policies are revocable (they can be changed). Some, however, are irrevocable . . . one that cannot be changed by the policyowner, unless they have the **Irrevocable Beneficiaries'** permission. 3-31

Designating beneficiaries – the choice is personal. However, **minors** cannot receive or control the proceeds of a policy. If a **minor** is named as a beneficiary and the insured dies before the **minor** reaches legal age, custody and guardianship questions may arise and the outcome determined in a courtroom after someone is appointed by the court to handle the money for the **minor**. The result may not be what the insured intended. 3-5

Beneficiaries and creditors – A policyowner who fails to name a beneficiary or designates his estate as his life insurance beneficiary will subject all proceeds from the policy to creditors chasing his estate. Using a named beneficiary, like a spouse, may avoid creditors of the policyholder but subject the proceeds to claims of your spouse's current and future creditors. Naming an irrevocable trust, that holds proceeds for the benefit of a named beneficiary, will do more to shield proceeds from creditors. 3-4

Grace period -- if the insured fails to make a premium payment, the insurance company will not immediately cancel the policy but instead, give the policyholder 30 days to pay the premium, during which time the policy is still in effect. 3-8

Automatic premium loan clause -- allows the insurance company to use a portion of a policy's cash value, when needed, to pay premiums to prevent a policy from lapsing. 3-9

Reinstatement clause -- after expiration of the grace period, a policy will lapse due to non-payment of premiums. When this occurs, companies will typically **reinstate** a policy if the policy has been lapsed less than 3 years, all back premiums are paid and the insured proves insurability. It is normally to the policyowners advantage to reinstate a policy if possible as it may have lower premiums or other benefits not available in a new policy. 3-8

Policy loans -- can only be taken out by the policyowner (you'll remember that the policyowner and the insured can be two different people). *Only permanent policies that build a cash value* (Whole life, Universal, etc) may be borrowed against. It is important to note that **any unpaid Policy Loans are deducted from the death benefit of the policy should the insured die**, thus *decreasing* the amount the beneficiary would receive. 3-31

Incontestability and Suicide Clauses – after 2 years have passed with a policy in force, the life insurer no longer has the right to contest the policy for any misstatements the insured may have made in his application. Suicides that occur within 2 years (may vary) may be contested, thereafter, the policy is incontestable. 3-2

Misstatement of age or gender – Both are important and can result from an honest mistake or even a typo. If discovered while the insured is living, the company can correct and request or refund the difference in premiums, or adjust the face amount of insurance.

If the insured is deceased, the company will adjust the amount of proceeds payable to that amount of insurance which the premiums paid would have purchased based on the correct age or gender. 3-7

Non-forfeiture option – If a policyholder stops paying premiums and allows a cash value policy to lapse, one of 3 non-forfeiture options comes into play. 3-29

- **Extended term** – Cash value (minus any loans) is used to pay for the face amount of insurance for whatever period it can last. Once depleted, the policy has no further value.
- **Reduced paid up** – Cash value is used to pay for a reduced amount of insurance with a single premium. The policy is fully paid up and continues.
- **Cash surrender** – The policy is surrendered and the policyholder gets his cash value.

POLICY EXCLUSIONS

Life insurance policies may contain exclusions . . . things or occurrences for which it will not pay out. The following is a list of the most common exclusions that may be found in life insurance policies: 3-14

- **Hazardous Occupation or Hobby Exclusion** – This exclusion will not allow a policy to pay out should the insured die as a result of a dangerous occupation or hobby
- **War and Military Service Exclusion** – Payment will not be made if the insured dies while a member of the armed services or dies as the result of an act of a declared war
- **Aviation Exclusion** – This exclusion prevents a policy from paying out should the insured die from aviation activities, except as a passenger on a commercial flight or a member of a commercial flight's crew.

TAXATION

Group life insurance -- When received in a lump sum payment, the proceeds paid from a Group Life Insurance policy are not taxable. The premiums towards a Group Life Insurance policy is not tax deductible to the

employee, however, the employer can deduct these premium payments as a business expense. 7-4

1035 Exchanges -- Since insurance and annuities are considered assets as well as property, gains incurred can be considered by the IRS for tax purposes. However, Section 1035 of the IRS Code provides that no gains or losses are recognized in certain situations:

- The exchange of a life insurance policy for another, or for an annuity or endowment
- The exchange of an endowment contract for another or for an annuity
- The exchange of an annuity for another

Any exchanges outside the above examples are considered taxable by the IRS. 7-5

EMPLOYEE BENEFIT PLANS

Allowable benefit levels – some group plans offer members additional coverage (for a fee). This allows insureds to add coverage to meet their individual needs. 5-7

Domestic Partnerships -- more employers are offering group plan benefits that provide coverage to the unmarried, unrelated and non-traditional (other than man/woman) employees and their domestic partners. Rules that govern this area are not uniform. In some cases, the employee might need to demonstrate that his or her partner is “eligible” which may be defined as:

- At least 18 years of age
- Not related
- In a committed relationship
- In an exclusive relationship
- Financially interdependent 5-7

RETIREMENT PLANS

Roth IRA's -- These differ in that the **contributions are made after taxes**. Earnings in Roth IRA's tax deferred and may be **withdrawn tax-free**. The owner of the plan must be at least 59 1/2 years old and must have held the Roth account for at least five years, or in case of death or disability. A withdrawal can also be made of up to \$10,000, for the purchase of a first home. Additionally, the principal is always available without penalty. 6-6

Education IRA's -- an account created as an incentive to help parents and students save for education expenses. The maximum contribution is \$2,000 in any given year. The beneficiary is someone under 18. Contributions are not tax-deductible, but grow tax-free. Distributions are tax free as long as they are used for qualified education expenses such as tuition, books, supplies and qualified room and board. 6-6

Thrift Funds & Accounts – a voluntary retirement savings plans for civilians who are employed by the U.S. Government. Maximum annual tax-deductible contribution is \$20,000 or 1 percent of pay. Funds grow tax-deferred and must be withdrawn like IRA's or rolled over into an IRA Rollover Account. 6-7

Vesting -- refers to a schedule that an employer establishes to determine what percentage of ownership the employee has in the **employer's contributions** to qualified plans. This schedule must satisfy certain IRS rules about tax qualification. Vesting generally relates to how long an employee has worked for their employer. Any **employee contributions to a plan are immediately vested**. 6-9

Fully funded -- means a retirement plan has enough capital, return on investment and other resources to pay all retirement payout claims. If a plan is not fully funded the Pension Benefit Guaranty Corporation will typically insure any shortfall that might occur. 6-9

Non-discrimination rules – in order for a pension plan to qualify for tax benefits it must meet federal non-discrimination rules designed to ensure that benefits of the plan do not disproportionately accrue to highly compensated employees. 6-9

SOCIAL SECURITY

Income or Death Benefit -- based on the wage earner's average lifetime earnings, an eligible survivor may receive a \$255 lump sum **death benefit** plus a monthly **income**. The higher the earnings, the higher the benefit. The percentage received is depends on the survivor's age and relationship to the wage earner. 11-4

UNDERWRITING

Medical Information Bureau -- an association of several hundred life insurance companies that stores information about any person who applies for insurance. The information reflects the person's health and physical

condition. The **MIB's** main purpose is to lessen the effects of *misrepresentation, fraud and withheld information*. 4-19

Attending Physician's Statement & More – a report requested by the insurer but filled out by a physician, hospital or medical facility who has treated or is treating a proposed insured. It is a summary of all pertinent medical conditions, illnesses and treatments of the insurance applicant. Inconsistent or missing information will compromise the risk analysis process. An applicant or APS that reveals a condition needing more information can delay approval of the policy pending confirmation and possible rating of the proposed insured. 4-18

Standard, Substandard or Preferred Risk Ratings -- Even if a person is determined to be a high risk, many insurance companies will still be able to offer some kind of policy. The healthy individual would be a **preferred risk**, while the unhealthy person would be considered a **substandard risk**. Insurance companies may issue the substandard risk a **rated policy**. A rated policy is one that takes into account the higher risk the insurance company is taking by issuing a policy to this person. The premiums on this policy would be higher. An insurance company may add a **flat extra premium charge**, which is a flat charge to the premium that may be permanent or temporary with respect to the life of the policy. Or, they may use a **multiple table extra premium method**. This method would cause the high risk to pay a percentage higher of the standard established premium rates. For example, a standard risk is assigned a 100% rate. A substandard risk, given a 150% rating, would pay 1.5 times the standard established premium rate. The third option is called a **lien plan**. Lien plans reduce the death benefit of the policy in the early years based on the proposed insured's risk. Then the insurance company places a lien against the policy, stating that if the death occurs within this lien period, the face value of the policy will be reduced by the amount of the lien. 4-20

HIV and AIDS Discrimination – Due to medical advances, the longevity of HIV and AIDS infected individuals is prolonged. While insurers can still decline an application on the basis of a positive ELISA test (the HIV test), they cannot indiscriminately test for HIV without the informed consent of the applicant. Once a test has been conducted, the insurer must maintain strict confidentiality regarding the results. 4-14

Genetic Testing – insurers cannot indiscriminately test for an applicant's genetic disposition for disease without informed consent. Results must be handled in a strict and confidential manner. 4-15

The Component's of an Policy's Premium – Underwriting and ratings are just one part of the process that determines premiums. Other factors include:

Mortality – more deaths than expected can create upward pressure on premiums.

Insurer Expenses – higher costs than projected influence the bottom line and the need for higher premiums.

Investment Return – poorly performing investments can haunt the ability to pay claims and create a need for higher premiums.

Reinsurance – the ability to transfer risk to other insurance companies can be critical to proper reserves, claims and the need for more premium income. 4-22

Mortality is the biggest element of how insurance companies calculate their premiums. The ability to accurately predict how many people of a certain age will die in one year is crucial. This allows the insurance companies to figure how long those they insure will live, when they will have to pay out benefits to the insured, and how much revenue they can expect to earn on Premiums in respect to a person's life span. 3-23

Comparing Life Policy Costs -- When evaluating policies, it is not enough to simply compare premiums. A lower premium does not automatically mean a lower-cost policy. So cost indexes have been developed to help measure and compare policies. Policy illustrations normally include Surrender Cost Indexes and Net Payment Cost indexes. They show average annual costs and payments per \$1,000 of coverage. Cost indexes such as these can be quite valuable when shopping for life insurance as long as numbers are compared for similar types of insurance plans. Additionally, special policy features, customer service and company financial strength should be weighed when considering the best choice. 4-9

Policy Retention -- Policy retention benefits everyone. A producer who keeps an open line of communication with his/her clients will have the opportunity for more sales, as well as be able to provide the maximum protection for that client. _It benefits the client because they always have the insurance protection they need. And, obviously, if a producer has a lot of happy clients, this is going to benefit the producer and the insurer financially. 10-27

CLAIM DUTIES

Insurers -- After receiving proof of claim, every insurer has to: 10-19

- Accept or deny the claim as quickly as possible, and no later than **40** calendar days
- Notify the claimant if more time is required to determine whether a claim is going to be accepted or denied, either partially or wholly. The claimant needs to be notified every 30 days if more time is needed
- Settle the claim by making a reasonable offer—insurers can't make an offer that's unfair or unreasonably low
- Pay any approved claims no later than **30** calendar days

Insureds – Upon death, survivors of the insured should notify the agent or insurer, cooperate in the completion of any necessary forms, and be prepared to send a certified copy of the insured's death certificate.

Agents – Agents should never make a claims decision. Claims handling is the duty of the insurer's staff. When a claim is reported to an insurance agent, their duty is to immediately report that claim to the insurer to investigate the facts. Failure to do so can lead to discipline, loss of license and damages incurred by the insured for the error.

LIFE & ANNUITY RIDERS

Guaranteed Insurability Rider - The Guaranteed Insurability Rider provides that the insured can purchase more life insurance at specified times without proof of insurability. It may be added to juvenile policies and is not available over the age of 40. When the insured reaches a certain age such as 25, 28, 31, 34, 37, or 40 where the option to purchase an additional amount of life insurance is available, they have 90 days to do so. The insured may also elect to purchase insurance at alternate optional dates such as marriage, or birth or adoption of a child. 3-17

Annuity Riders --Insurers have created a number of riders that, for a fee, can be attached to the basic annuity to guarantee a minimum return of principal or earnings, guarantee a minimum income to heirs, offer long-term care benefits and more. Most of these add-ons add to the cost of the annuity or reduce the overall return. 3-21