BUYER'S GUIDE TO LIFE INSURANCE

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HOW INSURANCE WORKS

The idea behind life insurance is very simple. You pay a premium. The premium is based on the insurer's prediction of how many years you will live. When you die, the insurer agrees to pay out a cash benefit to a designated survivor.

In the meantime, the company takes a portion of your annual premium and invests it. The company hopes that a combination of its investments and the premium you pay will amount to more money than the sum it must pay should you die.

That, in a nutshell, is life insurance stripped of all embellishments.

However, we all know life insurance isn't simple. Competition for your dollars is intense.

The premiums you pay help fuel an industry that includes some 2,000 companies nationwide and 380 licensed in New Jersey. These companies wrote more than $2.2 billion in premium in New Jersey in 1986.

To sell all that insurance, the industry maintains a large sales network. And to accommodate all the paperwork filled out by all of those life insurance salespeople, there is office staff, administrative staff, banks of computers, modern telecommunications equipment and other resources.

When you purchase protection for your family, the fee you pay, the premium, supports investment expenses, administrative costs, the death benefit, reserves (a fund to pay future claims), overhead, and commissions. So, you can see how important it is for the agent to make a sale.

To put you on an equal footing with a life insurance agent, it would help if you understood his or her trade language.

Insurance has words and phrases that are unique to the field. Here are just some of them:

•**Agent:** Authorized by the insurance company to act as its representative to sell and service insurance policies.

•**Application:** A signed form which gives information about the person buying life insurance. The form is used by the company to decide 1) whether to accept the risk; and 2) based on the amount of risk, the premium.

•**Beneficiary:** The person who will receive the insurance money after the insured's death.

•**Cash value:** The cash amount that is available if the policy is surrendered prior to its maturity or payment of a death benefit.

•**Convertible:** The right to exchange the policy for another, usually a whole life or other permanent policy, regardless of health.

•**Cost index:** A number that permits comparison of similar life insurance plans. The smaller the cost index number, generally the better the buy.

•**Dividend:** The part of your premium returned to you after the company pays its expenses and benefits and sets aside a pool of funds to cover future benefit payments (reserve).

•**Double indemnity:** The same as an accidental death benefit, it promises to pay the beneficiary an additional sum should the insured die as a result of an accident. An accidental death benefit must be purchased at additional cost.

•**Face amount:** The amount that will be paid to the beneficiary at the time of death or maturity of the policy.

•Grace period: All insurance companies will grant you at least 30 days to pay each regularly scheduled premium without canceling your policy.

•Insured: The person on whose life the policy is written.

•Lapsed policy: A terminated policy because of nonpayment of premium.

•Mortality table: A statistical table which calculates the probability of death according to age, sex and smoking status. This table is used to help fix your premium rate.

•Mutual company: A life insurance company which pays dividends to policyholders should the company generate surplus earnings. Its board of directors is elected by policyholders. These companies offer "participating" policies.

•Non-forfeiture benefits: The non-forfeiture benefits help avoid a cutoff of coverage to the policyholder. If you decide to discontinue your premium, you can obtain either of two non-forfeiture benefits which prevent complete loss of your policy. You can opt for paid-up insurance for a smaller amount, which provides you with a fully paid-up life insurance policy for an amount smaller than you originally had purchased. The longer your policy had been in force, the larger the amount of paid-up insurance it will provide should you discontinue your premium payments. Under a second option, you can purchase the same amount of insurance, but for a shorter period. This option provides an extended term insurance policy. If either non-forfeiture option goes into effect, rider coverage and all premiums cease. In order to reinstate your policy on a premium-paying basis, you may have to show evidence of insurability. The insurance under these options is not free. You are actually using the cash value to purchase either option.

•Nonparticipating insurance: Insurance policies which offer no dividends.

•Participating insurance: Insurance policies which do offer dividends.

•Policy: An insurance contract which lists all terms and conditions.

•Policy loan: The amount that can be borrowed from the company by the policyholder at a specific rate of interest. The cash value of the policy is used as collateral. If the policyholder dies before the loan is paid in full, the balance of the loan plus any interest owed is subtracted from the death benefit.

•Premium: The payment made by the policyholder to maintain the policy in force.

•Reinstatement: The restoration of a policy continued under a non-forfeiture benefit to a premium paying status. The insured will have to submit evidence of insurability and pay any past due premium plus interest. Reinstatement usually must occur within three years.

•Rider: An amendment to a policy which expands or restricts benefits or excludes certain conditions.

•Stock company: A life insurance company owned by stockholders. Stock companies are known as "nonparticipating" and generally do not issue dividends to policyholders. Rather, dividends are paid to stockholders.

DO YOUR HOMEWORK

Before you schedule an appointment to meet with a life insurance agent, try to determine if you need insurance. If you do, how much?

Not everyone needs insurance. Many people with grown families or no survivors could do without life insurance. So, too, can young adults without a spouse or children, or those individuals who have adequate protection provided from a group insurance policy through their employer.

If you feel you do need life insurance, to determine how much insurance you need, take stock of your financial resources.

First, who is dependent upon you for their financial well-being? It could be an elderly parent, or it could be a child.

Next, do a family financial audit. What money can your family expect to have on hand should you die? There may be survivor's benefits from social security. Perhaps you have a group life insurance policy from work. Any bonds? Stocks, savings, real estate, personal property, pension plan death benefits, business interests? Any income from your spouse or other sources? Total the amount.

Then, figure out how many bills your family is going to have to pay. There will be final expenses like your funeral and hospital bills, estate taxes and legal fees. Total living expenses like food, clothing, transportation, housing, medical care, child care, housekeeping and schooling. Be sure to take inflation into account. There may be other debts, like car loans, an education loan, credit card accounts, and other loans. Total this amount.

After you have completed a family audit, you will have some idea of your family's financial needs should you die. The difference between

your debits and assets should provide a clue to your life insurance needs.

Then, determine if your spouse will need life insurance, too. Or, your children. If your spouse is a homemaker, his or her services, such as child care and housekeeping, have a monetary value and will be costly to replace.

WHICH KIND OF INSURANCE PLAN TO BUY

There are many different variations, and the diversity grows with each year. Insurance companies change their products to reflect the investment climate of the time, tax law changes, population demographics, and any number of other variables. An explanation of insurance plans follows:

TERM

Term is the no frills model of the life insurance industry. It is relatively inexpensive, easy to understand, and in general, the best value for the premium dollar. However, there is a good chance your agent will not discuss term insurance as an option for your family unless you bring it up.

Term insurance is a temporary protection for your family. It must be renewed at the end of every preselected time period. This time period is called the term of the policy, and it can be a year — annual term — every five years, or even 20 years. It can even be for the length of a trip, as in travel insurance available at most airports. Or, it can last until a certain age, say 65. You and your insurance agent must decide what term length is best for you.

Today, most term insurance is renewable annually. Popular kinds of term insurance are level term, in which the death benefit remains constant although the premiums paid increase; decreasing term, in which the death benefit starts at a set amount only to decrease over the years in a preselected manner; and increasing term, in which the death benefit, or face amount of the policy, gets larger up to a preselected maximum. Increasing term is popular today as a hedge against inflation.

Probably the least expensive of all life insurance based on a rate per $1,000 is level term. It meets your family's basic needs at the lowest cost. But each time the term is renewed, the premium will go up.

Age plays a significant factor in the pricing of term insurance because, as you move higher up the mortality table, the odds of your surviving the year diminish. That means the insurance company is at a greater risk to pay your survivors the face amount of your policy. Therefore, your premium is increased. The higher your mortality rate, the higher your premium.

At some point (the exact number of years depends on your age when you purchase the policy, the price escalation of the term policy, and other factors), the premiums of term insurance reach and surpass the premiums of whole life insurance.

Before this time, you may want to convert your term insurance to some other form. Then again, your insurance needs at that age may not be as great as they are today. You may want to reduce the face value of your policy, thus reducing your premium, or cancel it outright. However, at age 25, or even 35, the savings difference between term and other forms of life insurance is substantial.

One drawback to term insurance is that the plan offers no savings element. Since the policy expires at the end of the term, there is no cash value to the policy. You get no money back, and no protection unless the term is renewed.

Term insurance is particularly attractive to young couples and families just getting started. It offers them protection they can afford. And to make up for the lack of a savings element, a smart insurance consumer can invest the difference between the premium price of term insurance and whole life.

There are two points that the consumer should consider:

First, ask if the policy is renewable. If not, the policyholder may have to qualify medically each time the term expires. This is called providing evidence of insurability. If the policy is renewable, then your policy can't be canceled if you develop a sickness or disability that would place you in a higher risk group.

Second, ask if the policy is convertible. This permits the policyholder to convert, or change, the policy to permanent insurance without evidence of insurability.

The premiums for plans with both these features may be slightly more expensive.

A newer form of term insurance is "revertible" or "re-entry." Whenever the term of the policy is up, the insured has the option to present medical proof anew that he or she is an insurable risk. If you pass the exam, your term policy renews at a lower rate. However, if you fail the exam, or choose not to take a medical physical, your term policy will be renewed at a rate no higher than your original rate.

The benefit of a revertible policy is that should you consistently prove to be in good health, your premium rate is lower. However, a word of caution: You might have to pay for the medical exam. Ask your agent! And, the evidence of insurability for the new premium rate could be contested for a two-year period. Another form of term insurance is mortgage redemption insurance. This form of insurance is directly tied to your mortgage balance. Should you die, it will pay your mortgage in full. The face amount, then, decreases over the years as you pay off your mortgage.

Because term insurance is not profitable to sell, many agents do not volunteer information about it. In a consumer magazine article, only 57 of 127 companies gave reporters requested data concerning term insurance.

So, be sure to ask your agent about this cost-effective life insurance product.

•Pluses: Least expensive; can invest difference in cost from whole life policy; can decrease face amount as insurance needs decrease; can be renewed to an age specified in your policy, in some cases up to age 95; can be converted to whole life.

•Negatives: Is temporary insurance; usually has no savings element; becomes increasingly more expensive.

WHOLE LIFE

Sometimes called straight life, whole life combines a permanent protection for your family with a savings element.

It differs from term insurance in several important ways: policies are in effect for your entire life if you maintain your premium payments, as opposed to a specified term; a portion of the premium you pay each year is set aside into a savings fund, called the cash value of your policy; and as the savings fund accumulates, interest earnings are tax deferred. One other major difference — whole life policies cost a lot more.

Life insurance companies have come up with various selling points. Agents might point out premiums will not increase and the policy will be in effect as long as you pay.

Agents might also point out that a whole life policy could be used as collateral. Your

company will loan you an amount equal to, but not more than, the policy's cash value. Although you do not have to repay the loan, interest is assessed on an accumulating basis and, should you die, the loan amount plus all interest will be subtracted from the death benefits.

Probably the biggest selling point from an agent's point of view is that life insurance is more than simply providing protection for your family. Whole life is an investment, agents might say.

However, as investments go, whole life policies are not the best for many people. Interest rates are low — generally no more than 4.5 percent. Expense charges can be quite high. Should you want to use the cash value, you must take out a policy loan, or surrender the insurance policy.

With a whole life policy, your beneficiary will receive only the face amount of the policy. Any cash value your policy has gained through your premium payments will revert to the company.

It works like this. The more <u>you</u> pay in to the company through <u>premium</u>, the less of <u>its</u> money the <u>company</u> has to <u>pay</u> to your survivors.

In effect, after paying premiums for several years, when you die, the money the company will be paying your beneficiary includes the cash you had accumulated after paying premiums.

To get a true measure of the death protection your policy affords your family, subtract the cash value from the face amount of the policy. Each year the policy is in force, the amount at risk to the company will decrease.

•Pluses: Premiums remain level; has savings element.

•Negatives: Interest rates low; higher expense and mortality charges than term; more expensive than term.

INTEREST SENSITIVE WHOLE LIFE

Insurance companies have come out with newer, "interest sensitive" policies.

Interest sensitive means the interest the policies can earn will fluctuate according to an index, stock prices, or some other financial measure specified in your policy.

To better understand the workings of interest sensitive policies, let's take a look at the three basic components to the rate you pay: the interest rate paid on the cash value; the cost of the death benefit (mortality charge); and the cost of expenses to the company.

By juggling the costs of these three components, companies can camouflage real costs to you while highlighting prominent selling features.

For instance, a company might highlight the interest rate it pays on the cash value of your policy. The insurance agent will show you illustrations showing how this interest rate will beat the competition, and why purchasing insurance through his or her company is your best buy.

What the agent might not say is that the company could have a higher than average mortality charge, or expense component. On a comprehensive basis, the higher interest earnings will be balanced by the more expensive mortality charge and company expenses. In the end, the product isn't a good buy after all.

Let's look more closely at the three components.

<u>Interest rates:</u> Interest rates are a selling point. Agents will show you illustrations to demonstrate investment earnings.

However, interest rates for whole life policies are low, generally guaranteed at no more than 4.5 percent. This rate is usually lower than rates you

can earn at financial institutions or through other savings plans. That's why some insurance consumers for years have held by the motto: "Buy term and invest the difference."

A benefit of the interest generated by any whole life policy is that the accumulated cash is not subject to federal income taxes until it is withdrawn. And then the amount must be more than the accumulated premiums you paid into the fund.

However, if the tax benefits are important to your family, you can obtain the same result by purchasing a term life insurance policy, and investing in a tax-deferred or tax-free savings plan.

<u>Expenses:</u> This charge covers a company's underwriting, commissions, billing, administering and handling expenses.

The company tries to recover its expenses as soon as possible. With an agent's first-year commissions and marketing expenses up to 100 percent of large premiums, the company does not want to risk your canceling the policy before it recovers its expenses.

Therefore, for the first few years, generally the first three, your policy will earn little or no cash value. Your premium goes to cover company expenses. That means should you surrender your policy during the first three years, you will get little cash value returned. Make careful inquiries.

<u>Mortality charge:</u> A portion of your premium is kept by the company to pay death claims. The charge differs by company and policy plan. It is important to learn how much of your premium will be directed towards a mortality charge. This money does not become part of the policy's cash value.

Another consideration before making **any** life insurance purchase is whether the company pays dividends. Mutual, or non-stock, companies offer their policyholders a dividend. They issue participating, or par, policies. Stock companies pay their dividends to stockholders and issue nonparticipating, or non-par, policies. Stock companies generally price their policies less than par policies, however, when dividends are considered, the par group may come out lower.

Dividends, just like interest rates, are a selling point and can be manipulated by the company to finalize a sale. Ask your agent about the long-term dividend projections. But remember, dividends are not guaranteed.

•Pluses: Permanent insurance; has a savings element; interest rates are competitive; can borrow from cash value; level premiums; and protection not contingent on annual medical examinations

•Negatives: Premiums are more expensive compared to term; cash value is not passed on to beneficiary when policyholder dies; protection element is expensive; company charges expense fees to manage investments.

UNIVERSAL LIFE

Universal life is a response to the industry critics who for years proclaimed "buy term and invest the difference."

Under universal life, the policy is separated into two distinct accounts: a term insurance policy and a cash value, or financial, account.

Universal life addresses many of the concerns consumers had about whole life. However, because it is a more complex form of insurance, it is even more important to beware the hard sell and become an educated consumer.

Agents point to several selling features. They will tell you that universal life is "flexible."

This means that, depending on your personal finances at any given year, you can elect to pay a higher or lower premium.

Here's how it works.

When you purchase a policy, you select a "target premium" with your agent.

There are several ways to pay the target amount.

If your financial condition is healthy, you could elect to pay the target amount, plus an additional amount. The extra premium will be added to your policy's cash value and will collect interest.

If your finances are tight, you can elect to pay a smaller cash premium. In this case, your cash value will grow at a slower rate, if at all.

Depending on your cash value's size, you may elect to pay <u>no</u> cash premium. Again, this will impact directly on the rate of growth of your cash value.

Universal life policies offer flexibility in other ways, too. Your agent will tell you that the face amount, or death benefit, can be increased or decreased, depending on your needs.

However, you must remember that your cash value will be correspondingly adjusted. With a higher face amount, the rate of growth of your cash value will be slower. With a lower face amount, the growth rate might be increased.

Also, because the company's liability changes, you may have to prove your insurability by taking a medical examination if you alter the face amount of your policy.

As far as the universal term coverage, universal life rates are competitive, but generally higher than an annual renewable term policy.

Agents also like to point out that universal life products pay a competitive interest rate.

Remember that interest rates are selling points. They can be manipulated to attract a buyer, while other expense elements can be hidden.

Just like whole life policies, the three basic elements come into play. Only in universal life, expense costs can be hidden even more easily.

<u>Interest rates:</u> The agent will provide you with an illustration projecting how quickly cash value will accumulate. All illustrations used to project

interest earnings must include a column demonstrating earnings at guaranteed rates. However, alongside the guaranteed rates, the company can provide an illustration of "expected" earnings. **These earnings are not guaranteed.** Guaranteed rates are spelled out in the policy, and generally are no more than 4 or 5 percent. And should you use your cash value as collateral for a loan, the portion used as collateral could only receive the minimum interest rate guaranteed in the policy.

Just as in whole life policies, interest earnings are tax deferred. However, your agent may point out that, unlike whole life policies, the cash value can be passed on to the beneficiary upon your death.

This is a half-truth. The policyholder has a choice of two death benefit pay-out options. Type "A" coverage pays the specific face amount of the policy, plus any accumulated cash value. Type "B" pays only the face amount of the policy.

Each plan has good and bad points. Under type A policies, the death benefit is larger. However, the cash value will accumulate at a slower rate because the insurance company will charge more for the mortality charges.

Under type B policies, the cash value accumulates at a faster rate, however, the total amount paid at time of death might be less.

Why is this so?

The risk portion of the universal life policy is covered by a term insurance coverage. The insurance company charges consumers a fee to cover the amount at risk — the amount the company must pay out from its own funds when you die.

As the cash value increases, the company has less at risk. The difference between the face amount of your policy and your cash value equals the amount at risk. Therefore, the term coverage carried by the company is reduced as the cash value grows. This reflects on the mortality charges you pay to the company.

Under type A policies, since the total amount paid to your beneficiary will grow as your cash value grows, the amount at risk to the company decreases at a slow rate. With more at risk, the company

must charge a higher amount to cover the mortality fee.

To decide which option of benefit payments you want, you have to consider your needs. Will your beneficiary need the face amount and cash value when you die? Or, are you using the policy as a savings and/or retirement vehicle? If your answer is the latter, you might opt for type B policies where you can save at a quicker pace.

In general, your cash value will be credited with the interest earned by the company minus a management fee of between .5 percent and 2 percent. The insurance company gains more of its profit from managing your financial account then from the mortality charge or expense fees. The rate of interest applied to your account can change monthly.

Mortality charge: The amount charged to pay your death benefit is called the mortality charge and is usually expressed in a fee per $1,000 per net amount at risk. Although the amount you pay is competitive under a universal life policy, it can be considerably more than the mortality charge for an annual renewable term policy.

Expense charge: This charge covers the company's expenses for underwriting, billing, administering, and processing your policy and financial account. It also pays for the agent's commission.

The expense component can be collected in several ways.

The company may deduct a large portion of the premium, anywhere from 5 to 9 percent, as expenses before any money is credited to your cash value.

This is called a "front load." Companies sell front loaded policies so that if you surrender your policy in the first few years, it has already recovered its expenses.

However, front loaded policies cost more in the first few years. The cash value will increase more rapidly in succeeding years. Therefore, the policies might appear to be more expensive, and they might appear to be not as good an investment vehicle as "back loaded" policies.

In a back load, instead of deducting expense charges from your premium payments, the company charges the bulk of these expenses as a surrender fee.

Your cash value accumulates faster. However, should you wish to cash in the policy during the first few years, the surrender charge could eat up any earnings.

The longer you keep a back loaded policy, the lower the surrender charge.

Finally, some policies are front and back loaded. The surrender charge is not as high as in back loaded-only policies, and premium charge is lower than front loaded policies.

Expense charges in back loaded policies can be easier to hide, since your agent might not mention the surrender fee.

When discussing a policy with your agent, make sure you ask how the expense charge is calculated, and whether it is front or back loaded.

Other charges can sometimes be added to a policy, such as a partial withdrawal fee, or a monthly fee for administrative costs.

What to ask your agent:

When you shop for a universal life policy, these are some key questions to ask:

•What is the guaranteed interest rate? What is the five-year average?

•What is the mortality charge? What is the five-year average?

•What is the expense charge? What is the five-year average?

•What is the policy loan interest rate and how is it calculated?

•Is there an excess interest penalty for early policy surrender?

•Is there a limit on partial withdrawal? Is there a partial withdrawal fee?

•Is the policy front or back loaded? What is the rate for the load?

Pluses: Savings collect higher interest; protection that is flexible; policyholder controls amount of premium; cash value that accumulates quickly and can be withdrawn or loaned; and death benefit options that allow your beneficiary to inherit any cash value accumulated.

Negatives: Initially more expensive than term insurance; interest rates may be lower than expected; high administrative costs and numerous fees; cost of insurance charges increase annually; and mortality rates based on a per $1,000 net amount at risk are high; sometimes figured on a per $1,000 net amount at risk basis, cost of insurance is high.

SINGLE PREMIUM LIFE POLICIES

Under a single premium policy, the policyholder makes a lump sum payment in the first year.

In the main, these policies are investment vehicles primarily purchased to earn tax-deferred or tax-free interest.

They are generally written in large face amounts.

Because of their large face amount, these policies are also looked at as an attractive trust account to pass on an inheritance.

Congress, however, has been considering legislation that would remove many of the tax advantages of single premium policies. Some legislators contend single premium life is merely an investment plan that was developed to sidestep the Tax Reform Act of 1986. Before purchasing a single premium life policy, you should contact your local congressman or congresswoman to determine the status of any reform legislation.

Pluses: Certain tax benefits may apply; one-time lump sum premium payment; attractive estate planning possibilities; and higher interest yields.

Negatives: Tax status could change, depending on tax law reform; company charges for investment, expense and mortality charges must be considered; there may be a costly surrender charge.

VARIABLE POLICIES

Variable life insurance is for those people who like to take risks. The policies combine a life insurance policy with a financial account that allows the company, on behalf of the policyholder, to invest in mutual funds, purchase stocks and buy or sell other securities.

Variable policies can be purchased under a whole life, universal life, or single premium life plan. The phrase "variable" means that the policy includes an investment account, and that account can be tied to securities, such as stocks, bonds or mutual funds.

Here's how it works.

Mrs. White takes out a policy that has a minimum guaranteed face amount. She pays $2,000 in premiums a year, every year the policy is in force. A portion of the premium is placed in an investment account and, depending on the performance of the investment account, the face amount will rise or fall each year, as will the policy's cash value.

For the policyholder, the risk factor comes into play because the investments are made in potentially higher-yielding items such as common stocks, money market funds, mutual funds, or long-term bond funds whose rates of return are unpredictable.

In whole life, investments are secured with guaranteed rates of return. Not in variable life. If the stock market goes up, so too does the face amount of the policy, and its cash value. If the market goes down, so do the face amount and cash value. The cash value could fall to zero. However, should you die, the policy will pay off a minimum guaranteed amount even if the face amount ordinarily would have dropped below that figure.

This type of insurance policy is gaining a larger marketshare as it attracts people who like to mix their insurance needs with riskier investment opportunities.

It should be remembered that insurance companies retain a portion of your earnings as a management fee and costs for the mortality charge may be higher than under a term life insurance policy.

Pluses: Potentially rapid accumulation of cash value and high face value; guaranteed minimum amount of face value.

Negatives: Poor investment choices may wipe out cash value and reduce face amount to a level insufficient to meet family needs.

VANISHING PREMIUMS

A common way to purchase insurance today is through a vanishing premium plan. In this way, the policyholder pays a larger premium for the first several years of the policy.

These large payments help to build a rapid cash value which, in later years, is used to pay the premium.

For instance, under a universal life plan, an annual premium for a $100,000 face amount might be $950 for a 40 year old. For a vanishing premium policy, that same coverage might cost $1750 for, say, eight years. In the ninth year and for each year thereafter, the policyholder will pay no out-of-pocket premium. Instead, the premium will be paid through deductions made in the policy's cash value. All the variables — the years of premium payment, cash value growth, etc. — can be adjusted to meet your family's needs.

However, it is important to remember that even though you will not be paying premium out-of-pocket in later years, the insurance company will subtract a premium amount from your cash value. Insurance is not free.

ENDOWMENT INSURANCE

Endowment insurance lets the policyholder protect his or her family and, at the same time, provides that policyholder with a sum of money as

specified by the policy, at an age specified by the policy, should the policyholder survive.

In other words, Mr. Green takes out a $50,000 policy to last until age 65. Should he die before age 65, his beneficiary would receive the $50,000. Should he survive beyond age 65, the insurance company would give him the $50,000. It carries a death benefit, plus money should you survive to a certain age that can be counted on for retirement, college tuition for your children, or for however you care to use it.

Premiums in an endowment policy are usually level, which means you pay the same premium each year. The face amount, or death benefit, doesn't change, either.

You and your insurance salesperson decide when the policy should mature. It usually runs through age 65.

The cash value, or the amount of savings earned for you by your policy, rises quicker through an endowment plan than through whole life plans. However, the premium amounts you must pay are higher. Endowment insurance is not commonly sold today.

CREDIT LIFE INSURANCE

This is a decreasing term insurance policy that is pegged to a loan that you may have outstanding. As the loan is repaid, the face value of the policy decreases. Should you die, the death benefit is paid to the person from whom you borrowed the money. This kind of insurance can apply to an auto loan, furniture loans, credit card loans, personal loans, etc.

It should be pointed out that this is an expensive kind of term insurance. Consumers might be better off purchasing an annual renewable term policy instead.

Pluses: Clears your estate from unpaid debts.

Negatives: More expensive than term insurance.

JOINT LIFE INSURANCE

When both husband and wife need life insurance, it is often less expensive to purchase a joint life insurance policy than two separate policies. This kind of insurance saves on administrative costs.

However, the death benefit will only be paid to the first to die with no benefit paid upon the death of the survivor.

Pluses: Less expensive that purchasing two separate policies.

Negatives: Would likely cancel policy in case of divorce.

LAST SURVIVOR INSURANCE

Last survivor insurance provides funds to pay estate taxes should you and your spouse die. Both the husband and wife are covered under the policy. Premiums are usually paid until one dies. At that time, under many insurance plans, the policy is paid

up. However, no death benefit is paid out.

Tax laws permit the transfer of one spouse's estate to the next without the burden of paying estate taxes. However, should both husband and wife die, the transfer of an estate to anyone else, including children, is subject to estate taxes.

Under this insurance plan, when the second spouse dies, the face amount of the insurance is paid. This amount is usually close to the estimated amount of estate taxes due. Therefore, your survivors will have a ready pool of cash to pay any inheritance taxes.

Pluses: Provides pool of funds to pay taxes instead of your heirs; good in cases where both parents die leaving young children.

Negatives: An expensive method of estate planning.

FAMILY INSURANCE

This is a plan that insures all members of a family, with the premium based on the insurability of the main wage earner. It can be whole life, term or any combination (such as a child on term but mother and father on whole life).

Pluses: Everyone on one policy; converts to whole life; insurance on dependents becomes paid up when primary policyholder dies.

Negatives: You would probably be over-insuring your family.

RIDERS

You can enhance almost any basic policy for a fee. These changes are called riders. They are expensive and, for many people, they are unnecessary. However, for specific individuals, these riders may make sense.

The three most common are:

1. Guaranteed insurability—no matter what medical condition you may be in, the company will insure you at some future date upon a special occurrence, such as marriage, the birth of a child, or at some scheduled age.

2. Waiver of premium for disability—should you become disabled, you will no longer have to pay premiums. There is a waiting period, and you must be under a specific age.

3. Accidental death, or double indemnity—doubles the face value should you die in an accident. If your family needs the extra protection of this rider, you could probably save money by increasing the face amount of your policy instead.

PRICING

As in purchasing any consumer product, be sure to comparison shop. The prices among companies vary.

Some companies offer low first-year premiums in order to attract you, but then raise the premiums at a rapid rate in succeeding years. Because you might keep your policy 5, 10, 20 or more years, it is important to judge cost over a period of time.

To help you compare prices, the National Association of Insurance Commissioners, an organization of state insurance regulators, has devised the "interest adjusted net cost index."

This index takes into account the rate of premium escalation as your policy grows older, and the timing of dividend payments to you.

It measures the cost per $1,000 of insurance, and is listed for 10-year and 20-year intervals.

The index is based on complex calculations but is also easy to understand. <u>The important thing to remember is that the lower the index number, the better the long-term price of the insurance product.</u>

Once again, however, your agent might not want to explain his company's net cost index. Your agent might explain that the index is complicated, or that it is not important to you. **Insist on getting it. The index applies to most forms of life insurance.**

FROM WHOM TO BUY

Many of the insurance company names are confusing. There are companies with the word "Veterans" that have no affiliation to the Veterans Administration or any veterans group. There are names of companies that include the words "government," or "United States," or "Federal" although the company is not a part of the United States government.

There are sound alike companies, and companies with familiar logos, such as the Rock, the Good Neighbors and the Pyramid people.

To make some sense of the marketplace, there are places where the consumer can check a company's background and financial condition.

To check a company's financial rating, go to the local library and look up "Best's Life Insurance Reports," published by the A. M. Best Co.

Under the insurance company's name, look for a paragraph on policyholder recommendations.

After you get a list of companies that are financially sound, comparison shop. The life insurance business is very competitive and price ranges differ dramatically.

THE AGENT

Years ago, life insurance was sold door-to-door by agents who not only had to sell the insurance, but make weekly premium collections.

Today, marketing has come a long way.

A few companies market policies by direct response. This means there is no agent involved. While you are forfeiting the personal contact and advice an agent can provide, it could lower the cost, as there is no agent commission paid.

However, most companies sell their products through agents.

Picking an agent can be as important as picking a policy. Some agents have earned designations such as Chartered Life Underwriter (CLU) or Certified Insurance Counselor (CIC).

Usually, such a designation is an indication that the agent is more knowledgeable and has devoted a considerable amount of time and effort to

prepare himself to better service a client's needs.

Recently, some insurance agents have begun to call themselves financial planners or estate planners.

In some cases, these individuals may be no more than insurance agents or brokers. There are, however, legitimate designations which qualify an individual as a financial or estate planner.

Some of these designations are: Certified Financial Planner (CFP); Chartered Financial Consultant (CFC); Registered Financial Planner (RFP); Registry of Financial Planning Practitioners; and Masters of Science in Financial Services.

The term "agent" in itself means that the individual represents the company. If the individual is a broker, he or she is supposed to represent your interests. Still, his or her compensation arises from the commissions earned by selling policies.

While we are on the subject, let's talk about commissions.

A commission for a good salesperson selling a whole life policy is usually in the range of 55 percent of the first year's premium. However, on a large policy, counting expenses, such as entertaining the prospective client, and bonus incentives, a salesperson can earn in commissions and other fees more than the total cost of the first year premium.

On the other hand, commissions for term insurance are usually in the 25 percent range of the first year's premium. In recent years, some companies have dramatically increased the commissions paid on term policies.

But in general, there is a greater financial incentive for the salesperson to make a sale on the higher priced insurance plans. You might want to ask your agent how much of your first year premium will be applied to his or her commission.

When an agent comes to your home, different insurance plans will be discussed, along with the merits and drawbacks to each. If your agent fails to mention term insurance, be sure to bring it up. Term is generally the least expensive form of insurance, and, possibly, the only protection you may need.

THE APPLICATION

Once you have settled on the company, and the type of insurance, it will be necessary to fill out an application form.

More problems may develop from the completion of an application than any other part of the process of buying or collecting from life insurance.

The application is the document used by the company to decide whether or not to issue the policy.

If some information is omitted or is inaccurate, it could be used as a basis by the company to deny a claim within the first two years.

So, do not rush the application process.

Usually, the agent is the one who actually completes the application.

The first part of the form will ask for general information. Where do you live? How old are you? What kind of work do you do?

Part one will also describe the kind of coverage you will be purchasing, the face value, premium frequency, and dividends.

Part two will ask for specific medical information. You may have to undergo a medical examination, including blood tests, urine tests and X-rays.

The amount of the face value and your medical history generally are determining factors as to how extensive the medical exam, if any, will be.

Before you sign the application form, be sure to read it. Check the answers to make sure they are complete and accurate. **Never** sign a blank application. And do not allow the agent to omit any health history. It is not his job to determine what is important. You may not be able to prove later that you gave that information to the agent.

The agent also will supply a report as part of the application form. He or she will list general observations, such as the condition of your home, your physical condition, what kind of neighborhood you live in, etc.

Again, depending on the size of the policy, the insurance company may undertake an investigation of your lifestyle, economic standing and your work duties. If an investigation of this nature is undertaken, the company must obtain your written permission before requesting any information from outside sources.

The insurance company may seek medical information from your physician, or your health insurer. Chances are it also will contact a medical information clearinghouse to see if you have a high risk medical history; whether you have ever applied for life insurance before; and whether your application has ever been turned down.

Should the company decide to issue the policy, and should you pay your premium, you are entitled to a 10-day free look, or a period of 10 days from the date you receive the policy during which you may cancel the policy and get a full refund. During these 10 days, the policy is in full force. If the policy is issued as a replacement of an existing policy, you must be provided a 20-day free-look period.

ILLUSTRATIONS

A tool often used by agents in selling a life insurance policy is an illustration of the values which can be generated by the policy.

Remember. An illustration is simply an example of how the policy **might** perform.

Companies are required to

illustrate guaranteed values on any illustration. The agent, of course, is going to emphasize the current values which are based upon the current interest rate. Be sure to ask how long that rate is guaranteed.

If you intend to keep the coverage beyond the age shown on the illustration, ask for an illustration that goes up to the requested age.

Again, remember! You can rely only on guaranteed values. If an illustration shows a build up of values in an account, there may be a charge applied if you wish to surrender the policy and be paid the value shown.

THE POLICY

Your policy should spell out several important consumer rights.

• It should tell you what the grace period is for payment of premium renewals, 31 days is customary, during which time your policy will remain in force (except for universal life, which generally has a 60-day grace period).

• It should explain in plain language policy loan provisions and interest rates to pay back a loan (for those policies with a cash value).

• It should explain when and how dividends are paid out, if any. Dividends may be used to pay part of the premium, they may be a cash return, or they may be applied as part of the savings element to gain additional interest. They also can be used to buy additional term insurance, or additional paid-up insurance.

• It should contain a contestability clause. No company can contest a claim after the

policy is in force for two years during the life of the insured.

A company can, however, contest, or challenge a claim at any time before that if it determines that fraud was committed or inaccurate information was provided on the application. One other point about the contestability clause. If you provided the wrong age on your insurance application, your beneficiary will be awarded the death benefit which would have been purchased by the premiums for your correct age. This is true even in the case of a claim filed more than two years after the policy was issued.

• It should list the beneficiary, or beneficiaries. The primary beneficiary is the person who will receive the benefits should you die. The contingent beneficiary is the person who will receive the benefits should the primary beneficiary already be dead at the time of your death. The beneficiary can be changed at any time, unless the policyholder has designated a beneficiary as irrevocable.

• It should spell out how the cash value is determined.

• It may also contain the settlement options. Settlement options are the various ways you or your beneficiary chooses to collect the death benefit. The beneficiary can collect a lump sum, can leave the money on deposit to earn interest, can collect a fixed amount at preselected time periods, can collect a fixed amount as long as the benefit plus interest lasts, or can collect a fixed amount over the course of his or her lifetime. A new settlement option deposits the benefit in a money market type account with an interest rate tied to an index. The beneficiary may write checks for the whole amount or any part of it at any time.

FILING A CLAIM

To make a claim, your beneficiary should notify the insurance company or your agent as soon after your death as possible.

The company will ask for a notarized copy of the death certificate. Death certificates are issued by the local coroner or other government official, and a funeral director can be helpful in obtaining one. Sometimes, the company will request an attending physician's statement, or even an autopsy report.

The insurance company will process the claim form. It will check to see if the policy premiums are up-to-date, identify the proper beneficiary, see if there are any outstanding loans due on the policy, and see if any dividends are owed to the policyholder.

If the company contests a claim, it can deny payment or it can dispute the amount of payment. In either event, the dispute is likely to be settled in court.

CONSUMER TIPS

•Even though rates for younger people are lower, it may not be to your advantage to purchase life insurance should you be single, with no dependents. The key question is, do you need financial protection for your family should you die?

•Shop around. Insurance rates under any of the plans listed in this booklet are

competitive. You can get a wide range of prices for similar insurance. Get comparison prices.

•Insurance products are difficult to price. However, to make things easier, companies are required to provide a price that can be compared to other products using a cost analysis index. Make sure you get this index price, and compare it with other companies' products. There is a second index that can help you to compare each company's investment plans and cash value accumulation.

•Salespeople can be motivated by the high commissions they can earn on the more expensive insurance products. Be wary.

•Tax and estate laws are constantly changing so be sure you get current tax information regarding how your policy will be affected before you purchase insurance.

•Your salesperson must provide you a copy of a buyer's guide that explains both your rights and the policy. Be sure to get a copy and read it before you purchase the policy.

•The cash value of your policy usually does not begin to accumulate until three years after the purchase. If you surrender your policy before this time, there will be little, if any, cash value returned to you.

•Don't sign any blank forms. Always give honest answers to application questions. And, make sure you read your policy.

DEPARTMENT OF INSURANCE

Write the New Jersey Department of Insurance should you have any complaints about the insurance salesperson, the policy, or the insurance company. Our address is the New Jersey Department of Insurance, CN 325, 20 W. State Street, Trenton, NJ 08625. Please be sure to include your policy number and the name of the insurance company.

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