An Insider’s Guide to Buying Life Insurance updated 04/2015

By Bob Deighton

Do you need life insurance?

Upon entering the business at the age of 20, I was told the life insurance industry is the world’s biggest lottery. There are hundreds of companies collecting billions of dollars and are betting you will live a long time. It is to your good fortune and theirs that most of the time they are right, but why should you pay for something that rewards you for dying? It seems there are millions of us who want to make sure our families and loved ones will be financially taken care of when we pass on.

In my 30 years in the life insurance business I have had the chance to speak with widows, widowers, children of parents who had no or very little coverage, and those who were adequately covered. Money does not replace a loved one and is not a substitute for the grieving process.The difference is the quality of life that the survivors experience. Losing someone you love and depend on is hard enough, but added financial problems can make a bad situation much worse or even disastrous.

There are many debates about which type of life insurance policy is best, but the two most important questions are:

1. How much coverage do you need?
2. For how long do you need it?

Some people need a large amount for a set number of years, while others require a smaller amount for their lifetime, and some should have a combination of the two. If you have a young family, it is advisable to replace ten times the income of the breadwinner(s) and cover your largest debt such as a mortgage. This can be over the million-dollar range for many. Those with grown families may not need as much life insurance coverage but may want to make sure their spouse, business partner, church, or charity is taken care of or contributed to when they die.

There are many choices when it comes to buying life insurance, and it would be a mistake to favor one type of policy over another in all situations. Circumstances are not the same for everyone and that’s why there are specific policies for different needs.

Is Term Life Insurance right for you?

In general, there are two types of life insurance coverage:

1. Term life insurance
2. Permanent life insurance

As the names suggest, term life insurance covers only a specific amount of time, while permanent life insurance offers lifetime coverage. Term life insurance can be a valuable planning tool to assure that you get the amount of coverage you need for a specific length of time at a premium that fits your budget. Please understand though, when the term is over you either must to try to find new coverage, pay incredibly high rates, or convert to permanent coverage if your policy allows.

The conversion option on term life insurance can be critically important. Some policies allow you to convert to permanent coverage only in the first five years while others will let you convert up until the end of the term period or until you've reached a certain age. Why is this important? Under the conversion option, you can move all or part of your coverage to a new policy without having to qualify medically or otherwise. That means there are no physical, medical, or financial questions in order to qualify for the new policy. The insurance company is contractually obligated to allow conversion to permanent coverage under the terms of the policy.

Let's say you are in the last year of a ten-year term policy and you have just survived cancer. Your policy is renewing and your annual premiums are going from $600 per year to a rate of $3500 per year and increasing each year after that. Cancer survivors generally have to wait six to eight years before an insurance company will consider insuring them on a new policy. If you have a company that allows you to convert to <u>any</u> of their permanent policies, you may be able to convert to a plan that is around $1800 per year if they offer a competitive permanent policy. That's why it is important to know what the conversion options are and what the company practices are regarding which policies they allow you to convert to. Some companies only allow conversion to their most expensive permanent plans while others are more liberal with this practice.

It would be a good idea to ask the agent selling the policy what the conversion options are and how competitive that particular company's permanent policies are compared to others. It may be better for you to pay a few extra dollars per month with a company that has better conversion policies available on their term insurance versus one that has limited conversion options.

There are several options for term life insurance these days. The most popular term policies are ten, fifteen, and twenty-year plans. There are also several companies that now offer twenty-five and thirty-year terms. The longer period you choose, the higher the premium. The reason term insurance is cheaper than permanent coverage is because the insurance companies know there is a much smaller chance that they will have to pay a claim. The longer the period, the more likely you are to keep a policy, thus increasing the risk to the insurance company. Some people have the misconception that term insurance isn't profitable and that insurance companies don't like selling it. This could not be further from the truth! Term insurance is extremely profitable because so few die during the term of the policy. The average lifespan of a male in the United States is almost 80. You would be hard pressed to find a term policy that covers you well into your eighties and yes, many people in their eighties still want life insurance.

What about Permanent Life Insurance?

Now we move on to permanent coverage- so many choices and so much confusion. There are four types of permanent life insurance that I will discuss here:

1. Whole life insurance

2. Universal life insurance
3. Variable life insurance
4. Indexed universal life insurance

In general, I have often found that universal life and indexed universal life are the best options. Here I will explain how these four types of coverage work and the costs and benefits of each.

Whole Life Insurance

The standard of the industry for over 100 years was whole life insurance. With whole life insurance, premiums are guaranteed not to increase for the life of the insured. The main problem with whole life insurance is that it is too expensive. Most young families cannot afford to get adequate amounts of coverage on the breadwinner with whole life insurance. In my opinion and experience whole life insurance is a waste of money; it lacks the lower pricing and flexibility of universal life.

Some agents sell whole life insurance based on dividend projections but this can be very misleading. Dividends on whole life insurance are not like dividends on a stock or mutual fund. They are simply a return of some of the premium that the insurance overcharged you in the first place. Dividend paying life insurance policies (participating) are ALWAYS more expensive than non dividend paying policies (nonparticipating). My advice is not to trust those dividend projections because they are completely dependent on what the insurance company’s board of directors decide to do and in almost every case I have seen in 30 years the insurance company did not live up to those projections.

Universal Life Insurance

Universal life is a type of permanent life insurance that allows the insured to change their premium and coverage amounts based on how long they want the coverage to last. Universal life polices from the 1980s to early 2000s had left some consumers with a bad experience when agents and companies were selling policies predicting unrealistic rates of return on the cash values and under-funding the policies. As a result, interest rates went down and people who thought they had a level premium for life discovered that they now had to pay more to keep the policy going. It’s easy to blame the insurance company and even easier to blame the agent who sold it, but the policyholder is responsible to read their statements every year and try to understand what is happening. If they don’t understand, they need to ask questions. One of the most important things a consumer can do is request an “in-force” statement from the insurance company asking to see how the policy will perform based on the current status. This way you can see which direction your policy is going and take action before it is too late.

Some companies now offer guaranteed premium universal life insurance at very attractive rates. This is accomplished by adding a guaranteed premium rider to the policy. The rider guarantees that premiums will never increase no matter what happens to the interest rates or how the cash value account performs in the policy. In my opinion, this is the best way to buy permanent coverage. It is much cheaper than whole life insurance and locks in a premium for a longer period than term insurance. In reality it is a *lifetime term policy*. It offers coverage for the rest of your life at a guaranteed level premium, not just twenty or thirty years. You can also set a premium schedule to have a guaranteed paid up policy by a certain age or period of time. This can be helpful to people who don’t want to pay for life insurance when they retire but still want to have coverage.

Another type of universal life policy that is available is a second-to-die plan. This policy pays the death benefit when the second insured dies. This type of plan is ideal for couples who want to leave a liquid estate for tax or other reasons.

Variable Life Insurance

Variable life uses the same concept of universal life but invests the cash values in separate accounts similar to mutual funds. The problems with variable life are numerous. The first problem is that the premiums on variable life are not guaranteed for more than ten or fifteen years. This means that if the funds don't perform well, you may have to put more money in to keep it going. Variable life also has expenses that can have a negative effect on the policy, especially if the values of your account start to go down due to stock market volatility. Every month, the insurance company has to deduct the cost of insurance for the face amount of the policy. If the value of the shares in the account goes down, they have to sell more shares in order to pay these insurance costs. As the policyholder gets older, the cost of insurance goes up and, again, more shares need to be sold in order to cover these costs.

Because of this dynamic, you can lose a significant amount of cash value in a short period of time with a variable life policy, and the policy itself may not recover unless additional premiums are paid. People are usually buying life insurance because they want something that is guaranteed, and variable life does not provide that.

Indexed Universal Life Insurance

Indexed universal life seems to solve the problems of variable life and can add the security of a premium guarantee. Instead of investing the cash value into mutual fund type accounts, the policy typically offers several stock indexing accounts. With these types of accounts, there is a moderately high upside and no risk of loss. For example, if an account has a good year, the returns can be in the double-digit range and you will not lose previous years' gains due to a market decline.

My clients who have purchase these policies have not lost one dime due to stock market volatility, and many have called to thank me. If your goal is to accumulate a larger nest egg via life insurance with the idea of using this money to supplement retirement or help fund a child's education, then this is an excellent vehicle to use.

Another advantage of universal life is the flexibility of premium payments. You can pay more or less into the policy depending on your goals, and you can also lower the death benefit (thus lowering the cost) without having to cancel the whole policy. With the recent economic downturn, more people have called me to see what their options are with their policies. Many who have had policies for at least a few years are able to skip premium payments for six months or more without the risk losing their coverage. You cannot do that with term insurance. Some Indexed Universal Life plans also offer very attractive tax advantaged withdrawal and loan provisions that can help build a solid supplemental retirement income.

Accelerated Benefits Riders

An accelerated benefits rider is an exciting new feature offered on some life insurance policies. These riders allows you to access the death benefit while you are still living in order to help pay for expenses related to long term care, critical illnesses like cancer, strokes, ALS, heart attacks, or even terminal illness. The way this works is you trade a smaller benefit while you are living versus having to die to collect.

For example, if you have a policy with a chronic illness benefit, you could access 20% of your death benefit per year if you qualify for the benefits. The benefit triggers are the same as a typical longer term care policy. If you have severe cognitive impairment or are incapable of performing two or more basic activities of daily living, then you may be able to access this money. If you have a $250,000 life insurance policy, you would be able to access $50,000 per year against the policy for long term care needs. This is usually discounted to $35,000- $40,000 because you are taking the money before you die, but if you need the money while you are living, it may be well worth it. It is better to get something significant now versus having to wait to die to collect later.

If you have a critical illness like a heart attack or stroke you may be able to access $100,000- $200,000 while you are living. I have read about cases where the insured person was able to use accelerated money from the life insurance policy to get a life saving treatment or procedure that wasn’t covered by health insurance. Now that’s what I call a *REAL* life insurance policy. In most cases the insurance company will waive all or part of the premiums on the policy while you are receiving benefits, also guaranteeing that you will still have some life insurance left over even if you use up the long term care or critical illness benefit. These benefits are not available on all policies, but it is definitely worth asking about.

Getting quotes

When it comes to buying term life insurance, it is very easy to get a quote. The problem is that quotes are just estimates and really don’t mean anything until you complete and pass the physical that is required by the insurance company. But beware - most advertised rates are in the ‘preferred plus’ range or best underwriting categories that most people will not qualify for. The truth is that only ten to twenty percent of the public will qualify for those rates. With some companies this percentage is even smaller.

This is where the experience and knowledge of an excellent life insurance agent can be valuable. Having comprehensive understanding of how the different companies underwrite their business can save time and money. There can be over fifty different criteria that life insurance companies use to determine a risk class, and each risk class carries different pricing. I recently had a request for a quote where one of the client’s parents died at age 52 due to cancer. With most companies, that fact would have kept him out the best underwriting category. I found him a competitive policy where the family history of cancer wasn’t an issue. The difference was that he qualified for a policy for $700 per year that otherwise would have been $1200 with every other carrier.

Any agent can quote a rate, but getting it for the client is another story. Some agents try to get an application commitment from the client by always quoting the preferred rate classes knowing that the client won't actually qualify. The agent hopes the client will just take the policy at the higher rate when it is issued so they don't have to go through the physical and application process again. What a huge waste of time and money! If you have any doubts about the validity of a quote, ask your agent to provide you with a copy of the underwriting guide that shows the height and weight range and other criteria for the different underwriting classes. This can save you an enormous amount of time and aggravation.

Finding an agent who will underwrite your policy as much as possible up front is very important. The key is the number of questions they are asking you. If they don't ask many questions, the chances are they aren't doing their homework and you will end up paying more than you have to. It is also your responsibility as a client to be honest with the agent about your medical, personal, and family history. The agent can't give you an accurate quote if you withhold information.

What if I am diabetic or have a health problem?

As far as life insurance is concerned, there is good news for diabetics and folks with other medical histories. If you do a good job controlling your blood sugar, you can qualify for a good rate on a life insurance policy. There are several companies that will now offer a standard rate for Type II diabetics who keep their A1c number under 6.0, even if they are on medication. There are also companies that will make reasonable offers for people who have had heart disease, cancer, rheumatoid arthritis, or other serious illnesses that may have once been considered uninsurable. By inquiring with many companies, I have been able to get decent offers for many clients who had previously been turned down or told by other agents that they were uninsurable. Some companies are better at insuring certain types of risks than others, so it is best to find an agent who has the resources to complete these kinds of inquiries with a broad range of companies.

No Exam Life Insurance

There are also a few companies that offer life insurance without requiring a physical exam. They usually limit the amount of coverage to $150,000 to $500,000 depending on the company. The premiums on these plans are twenty to fifty percent higher than fully underwritten plans but bypass the blood test and physical required by most companies. This doesn't mean they will not get your medical records or ask any questions. They all run a MIB (Medical Information Bureau) report to see if you have been rated or declined by other companies.

I have found that companies that offer this kind of policy are typically at the lower end of financial ratings. Exposure to blood born diseases such as HIV and hepatitis C are prevalent throughout our society, and these companies will surely be hit with claims related to these conditions in the next twenty years. Because they are insuring a riskier group of people, they must charge more. In any case, if you don't want to complete a physical, one of these plans will make sense for you. One of the worst things you can do to your family is to go without life insurance. These kinds of coverage are easy for people who tend to procrastinate because of the physical required by most plans.

There are some companies that offer guaranteed issued life insurance. These policies are the most expensive and have very limited actual coverage the first few years. If the insured dies in the first year, the company will not pay the face amount but will refund the premiums paid. In subsequent years, the amount payable increases to a point where they will eventually pay the full death benefit. Companies that sell these plans come and go. There always seems to be a new one popping up and going away every other month. I recommend using caution when purchasing this kind of coverage. If they don't ask any medical questions or require a blood test or physical, BEWARE.

Selecting a company

<u>Another thing that is often overlooked by agents is the quality of customer service some companies provide and the safety of the companies</u>. This is where cheapest isn't always the best option. When I run a comparison quote for a prospect, I generally look at the top eight companies in terms of price. Invariably there will be two or three companies that I try to avoid because their customer service is terrible. I will write the policy if the client insists, but I try to warn them about the length of time it will take and how inflexible the company can be when it comes to underwriting decisions. Some companies can take up three months to make a final decision on a policy. Because they are offering a bottom line product, they are usually understaffed in the underwriting department and will not communicate directly with the agent. This leaves a communication void between the agent and the underwriter that can result in many delays and ultimately a higher rate for the client.

There is no reason it should take more than two weeks to underwrite a policy if there are no medical records needed. If the underwriting department doesn't function efficiently, then the rest of the company service may fall short as well. Sometimes it is worth spending two or three dollars more per month to go with a company that is financially stable and will provide better service. After all, do you really want your spouse to have to deal with poor service or a company that is insolvent when it's time to file that million-dollar claim? I didn't think so. That's why it is critical to deal with an agent who understands what is happening with the management of the different companies in the business.

Selecting an agent

Lastly, the type of agent you choose will probably determine the price you pay for life insurance. In general, there are two types of life insurance agents:

1. 'Captive' or company agents
2. Insurance brokers

'Captive' or company agents generally can only provide products for the particular company they sell for, with few exceptions. Realistically, no one company will have the best policy for every person all the time. If you go with a captive agent, you are limited by their scope of knowledge about their own product and services. Companies that sell mainly property and casualty insurance (homeowner's and auto) usually don’t offer competitive life insurance. They don’t have to. They know people will buy from them out of convenience or because they think that they will get better service if they bundle their coverage together. I can’t tell you how many sales I have made when Down On the Farm Insurance Company (not a real company) cancelled the auto coverage because of a claim and now the clients would like to change everything. They are shocked to learn they have been paying too much for their life insurance all along.

Insurance brokers are agents that generally represent at least five or more companies. Most take the time to ask all the important questions that will enable them to find you a policy that is competitive but will also provide excellent service. State insurance departments now have websites that will allow you to view an agent’s record and which companies they represent. Many agents like myself are licensed in multiple states and do business via internet leads and referrals. We rarely meet our customers face to face but are still able to provide excellent service with highly rated companies. In fact, I have learned that most people prefer to do business this way because they are busy and find it more convenient. This way they don’t have to clean their house, put their makeup on, or deal with an agent sitting at the kitchen table for three hours waiting for them to write a check. It’s quick and easy, and if you don’t like the way it’s going with an agent you can just hang up and try someone else. Here are actual messages I recently received from two new clients:

Hi Bob,
I received the policy today. Signed it and will be mailing it back tomorrow.
I have to say that I really like the way you do business, Even though you're
in a different location, I've have more success with your services than some of the local businesses surrounding me.
Last, what other financial services do you offer?
Thanks,
DW

Hi Bob,
I just wanted to thank you for taking care of my insurance needs. I am extremely happy with your service.
I must say that I was very disappointed with couple of local agents that I contacted - they were more interested in selling me stuffs and services that were financially NOT appropriate to my situation.
Though I was not sure whether I wanted to deal with an agent who is not local, I am glad I did.
If any of my friends and colleagues are looking for insurance needs, I will absolutely recommend you.
Thank you again.
MC

Conclusion

With the modern age of technology and information revolutionizing the way we live and communicate, it’s the consumer who wins when they take advantage of doing business with an insurance broker. Buying life insurance is one of the most important financial decisions you will make. There’s no other product that offers so much benefit for such a small amount of money. It could determine whether your children can afford to go to college, your spouse is able to keep your home, or the family business is able to continue. If you have the chance to talk with a widow whose partner's life ended early, ask her whether life insurance mattered and she will say "absolutely!"

I hope this guide has been helpful. It was written out of experience and caring. Please contact me if I can be of service.

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Glossary

Level Term life insurance- Premiums and death benefit are fixed for a certain period of time such 10,15,20,25, or 30 years.

Decreasing term insurance- Premiums are fixed but the death benefit decreases each year.

Annual renewable term- Premium increase annually but death benefit stays the same each year.

Return of premium term insurance- Term insurance that guarantees to return all premiums paid at the end of the term if insured is still living.

Accidental Death Insurance- Pays only if the insured dies accidentally subject to the limitations, terms, and exclusions of the policy.

Conversion option- A provision in a term life insurance policy that allows the policyholder to change to a permanent policy without evidence of insurability, meaning no medical questions or exams. The new policy is not subject to a new contestability or suicide clause.

Permanent Life Insurance- Forms of life insurance other than term or accidental death insurance. These include universal, indexed, variable, and whole life.

Cash value- Amount of money available for loans, withdrawals, or at surrender of a policy. It is the savings account that accumulates in permanent life insurance or ROP Term.

Premium guarantee rider- Additional benefit that can be added to a universal life policy that will guarantee premiums will not increase for a specific period of time, or for life.

Universal Life insurance- Premiums can be guaranteed for a specific period, for life, or paid on an estimated basis contingent upon interest rate performance of the cash value and costs of insurance. Death benefit can be level or increasing. Increasing death benefit option may require higher premiums or result in lower cash values. Premiums and death benefit are flexible and can be changed during the life of the policy by the policyholder. Premiums can be “skipped” or “paid up” if there is sufficient cash value to cover the cost of insurance.

Second to Die Life Insurance- A Universal Life policy that pays the death benefit when the second insured person dies. This type of plan is a popular estate tax planning tool to help pay estate taxes or create a liquid estate.

Indexed Universal Life- Cash values are invested in stock index accounts that participate in the growth of certain stock market indexes. The accounts are not subject to stock market decline but typically pay less than actual index return in a good year. This takes the volatility out of the performance of the indexed accounts. Some policies allow for a lifetime premium guarantee rider to be added.

Variable Life Insurance- Premiums are set on an estimated basis contingent upon performance of “separate accounts” or mutual fund type investments and cost of insurance. Premiums are typically guaranteed for ten to fifteen years and may need to be increased if the underlying investments do not perform well.

Whole Life Insurance- Premiums and death benefit are set for life and are not subject to change by the policyholder or company. Premiums must be paid in order to keep policy in force or loans must be taken if there is a cash value to keep the policy in force. Some policies pay dividends that may be used to purchase additional coverage or help pay premiums later. Dividends are not guaranteed or considered dividends in the commercial sense. They are a return of a deliberate overcharge by the insurance company and the insurance company has no legal obligation to pay the dividend back to the policyholder.

Incontestability clause- If there is a death during the first two years of a new life insurance policy, the insurance company may investigate the insured to see if they were honest and forthright on the application they originally signed. If fraud is found, the insurance company has the right to contest the claim. Once a policy is past the two-year period it is considered incontestable and the insurance company is obligated to pay.

Suicide clause- No claim will be paid for suicide in the first two years of a life insurance policy.

Medical Information Bureau- An organization that life insurance companies report to when there has been an adverse underwriting decision made on an applicant. This is similar to a credit report when applying for life insurance. For more information, go to www.**mib**.com.