

Life Insurance Basics

Life insurance is an agreement between you (the policy owner) and an insurer. Under the terms of a life insurance policy, the insurer promises to pay a certain sum to a person you choose (your beneficiary) upon your death, in exchange for your premium payments. Proper life insurance coverage should provide you with peace of mind, since you know that those you care about will be financially protected after you die.

The many uses of life insurance

One of the most common reasons for buying life insurance is to replace the loss of income that would occur in the event of your death. When you die and your paychecks stop, your family may be left with limited resources. Proceeds from a life insurance policy make cash available to support your family almost immediately upon your death. Life insurance is also commonly used to pay any debts that you may leave behind. Life insurance can be used to pay off mortgages, car loans, and credit card debts, leaving other remaining assets intact for your family. Life insurance proceeds can also be used to pay for final expenses and estate taxes. Finally, life insurance can create an estate for your heirs.

How much life insurance do you need?

Your life insurance needs will depend on a number of factors, including whether you're married, the size of your family, the nature of your financial obligations, your career stage, and your goals. For example, when you're young, you may not have a great need for life insurance. However, as you take on more responsibilities and your family grows, your need for life insurance increases.

There are plenty of tools to help you determine how much coverage you should have. Your best resource may be a financial professional. At the most basic level, the amount of life insurance coverage that you need corresponds directly to your answers to these questions:

- What immediate financial expenses (e.g., debt repayment, funeral expenses) would your family face upon your death?
- How much of your salary is devoted to current expenses and future needs?
- How long would your dependents need support if you were to die tomorrow?
- How much money would you want to leave for special situations upon your death, such as funding your children's education, gifts to charities, or an inheritance for your children?

Since your needs will change over time, you'll need to continually re-evaluate your need for coverage.

How much life insurance can you afford?

How do you balance the cost of insurance coverage with the amount of coverage that your family needs? Just as several variables determine the amount of coverage that you need, many factors determine the cost of coverage. The type of policy that you choose, the amount of coverage, your age, and your health all play a part. The amount of coverage you can afford is tied to your current and expected future financial situation, as well. A financial professional or insurance agent can be invaluable in helping you select the right insurance plan.

What's in a life insurance contract?

A life insurance contract is made up of legal provisions, your application (which identifies who you are and your medical declarations), and a policy specifications page that describes the policy you have selected, including any options and riders that you have purchased in return for an additional premium.

Provisions describe the conditions, rights, and obligations of the parties to the contract (e.g., the grace period for payment of premiums, suicide and incontestability clauses).

The policy specifications page describes the amount to be paid upon your death and the amount of premiums required to keep the policy in effect. Also stated are any riders and options added to the standard policy. Some riders include the waiver of premium rider, which allows you to skip premium payments during periods of disability; the guaranteed insurability rider, which permits you to raise the amount of your insurance without a further medical exam; and accidental death benefits.

The insurer may add an endorsement to the policy at the time of issue to amend a provision of the standard contract.

Types of life insurance policies

The two basic types of life insurance are term life and permanent (cash value) life. Term policies provide life insurance protection for a specific period of time. If you die during the coverage period, your beneficiary receives the policy death benefit. If you live to the end of the term, the policy simply terminates, unless it automatically renews for a new period. Term policies are available for periods of 1 to 30 years or more and may, in some cases, be renewed until you reach age 95. Premium payments may be increasing, as with annually renewable 1-year (period) term, or level (equal) for up to 30-year term periods.

Permanent insurance policies provide protection for your entire life, provided you pay the premium to keep the policy in force. Premium payments are greater than necessary to provide the life insurance benefit in the early years of the policy, so that a reserve can be accumulated to make up the shortfall in premiums necessary to provide the insurance in the later years. Should the policyowner discontinue the policy, this reserve, known as the cash value, is returned to the policyowner. Permanent life insurance can be further broken down into the following basic categories:

- **Whole life:** You generally make level (equal) premium payments for life. The death benefit and cash value are predetermined and guaranteed. Any guarantees associated with payment of death benefits, income options, or rates of return are based on the claims-paying ability of the insurer.
- **Universal life:** You may pay premiums at any time, in any amount (subject to certain limits), as long as policy expenses and the cost of insurance coverage are met. The amount of insurance coverage can be decreased, and the cash value will grow at a declared interest rate, which may vary over time.
- **Index universal life:** This is a form of universal life insurance with excess interest credited to cash values. But, unlike universal life insurance, the amount of interest credited is tied to the performance of an equity index, such as the S&P 500.
- **Variable life:** As with whole life, you pay a level premium for life. However, the death benefit and cash value fluctuate depending on the performance of investments in what are known as subaccounts. A subaccount is a pool of investor funds professionally managed to pursue a stated investment objective. The policyowner selects the subaccounts in which the cash value should be invested.
- **Variable universal life:** A combination of universal and variable life. You may pay premiums at any time, in any amount (subject to limits), as long as policy expenses and the cost of insurance coverage are met. The amount of insurance coverage can be decreased, and the cash value goes up or down based on the performance of investments in the subaccounts.

Note: *Variable life and variable universal life insurance policies are offered by prospectus, which you can obtain from your financial professional or the insurance company. The prospectus contains detailed information about investment objectives, risks, charges, and expenses. You should read the prospectus and consider this information carefully before purchasing a variable life or variable universal life insurance policy.*

Your beneficiaries

You must name a primary beneficiary to receive the proceeds of your insurance policy. You may name a contingent beneficiary to receive the proceeds if your primary beneficiary dies before the insured. Your beneficiary may be a person, corporation, or other legal entity. You may name multiple beneficiaries and specify what percentage of the net death benefit each is to receive. You should carefully consider the ramifications of your beneficiary designations to ensure that your wishes are carried out as you intend.

Generally, you can change your beneficiary at any time. Changing your beneficiary usually requires nothing more than signing a new designation form and sending it to your insurance company. If you have named someone as an

irrevocable (permanent) beneficiary, however, you will need that person's permission to adjust any of the policy's provisions.

Where can you buy life insurance?

You can often get insurance coverage from your employer (i.e., through a group life insurance plan offered by your employer) or through an association to which you belong (which may also offer group life insurance). You can also buy insurance through a licensed life insurance agent or broker, or directly from an insurance company.

Any policy that you buy is only as good as the company that issues it, so investigate the company offering you the insurance. Ratings services, such as A. M. Best, Moody's, and Standard & Poor's, evaluate an insurer's financial strength. The company offering you coverage should provide you with this information.

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