

Class 6 Outline
Business Finance 640
Autumn Quarter, 2007

This class begins with a discussion of several other types of life insurance that were not covered in the previous class. However, the focus is on the basic contractual provisions that appear in life insurance contracts, many of which are required by state law.

We will review the ownership, entire contract, incontestable, suicide, grace period and reinstatement and misstatement of age clauses. We will also discuss provisions pertaining to beneficiary designation, change of plan, payment of premium, assignment and policy loans. We will also look at the exclusions governing suicide, war and aviation.

With respect to dividends, we will discuss how dividends on a cash value policy are relatively small during the early years and then increase, aided by excess interest on a growing legal reserve. We will also point out that insurers occasionally change their dividend scales.

We will review various nonforfeiture options and settlement options. We will note the difference between the minimum nonforfeiture values required by state law and the nonforfeiture options adopted by insurers, some of which can be more liberal.

Finally, we will review briefly the additional life insurance benefits that can be added to a policy. These include the waiver-of-premium provision, guaranteed purchase option, accidental death benefit rider, cost of living rider, and accelerated death benefits rider.

I. Other Types of Life Insurance

- A) Current Assumption Whole Life Insurance
 - 1. Nonparticipating whole life policy in which the cash values are based on the insurer's current experience with respect to mortality, investment income, and expenses
 - 2. Guaranteed minimum cash values; higher cash values are based on current interest rates
 - 3. Two forms
 - a. Low premium products
 - b. High premium products
- B) Indeterminate premium whole life insurance—allows the company to adjust premiums based on anticipated future experience
- C) Modified Life Insurance—lower premiums during the early years
- D) Insurance for Preferred Risks
 - 1. High minimum amounts
 - 2. Lower rates and more selective underwriting
- C) Second-to-Die Life Insurance
- D) Savings Bank Life Insurance
- F) Industrial Life Insurance
- G) Group Life Insurance

II. Life Insurance Contractual Provisions

- A) Ownership Clause
 - 1. Possible owners: the insured, beneficiary, or a third party
 - 2. Owner's rights: may change the beneficiary (unless irrevocable); surrender the policy; receive dividends; elect settlement options
 - 3. Ownership change

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- B) Entire Contract Clause
- C) Incontestable Clause
- D) Suicide Clause
- E) Grace Period
- F) Reinstatement Clause
 - 1. Allows a lapsed policy to be reinstated
 - 2. Requirements: evidence of insurability; payment of past-due premiums; repayment or reinstatement of policy loans; must be reinstated within a certain period, such as three years or five years; policy must not have been surrendered for its cash value.
 - 3. Advantages: lower premiums; no additional acquisition expenses; cash values and dividends are higher; suicide and incontestable clause may have expired.
- G) Misstatement of Age or Sex Clause
- H) Beneficiary Designation
 - 1. Primary and contingent
 - 2. Revocable and irrevocable
 - 3. Specific and class
- I) Change of Plan Provision
- J) Exclusions and Restrictions
 - 1. Suicide clause
 - 2. War clause
 - 3. Aviation exclusion
- K) Payment of Premiums
- L) Assignment Clause
- M) Policy Loan Provision
 - 1. Nature—the policyowner can borrow the cash values.
 - 2. Advantages—a low annual percentage rate; no paperwork; flexibility in repaying
 - 3. Disadvantages—heavy borrowing may cause policy to lapse; the amount of protection is reduced.
- N) Automatic Premium Loan
 - 1. Nature—allows overdue premiums to be paid by borrowing from the cash value at the end of the grace period.
 - 2. Purpose—to prevent the policy from lapsing
 - 3. Main disadvantages—may be overused; amount of protection is reduced.

III. Dividend Options

- A) Sources of Surplus for Dividends
 - 1. Higher interest earnings than assumed
 - 2. Lower mortality than expected
 - 3. Lower operating expenses than expected
- B) Ways of Taking Dividends
 - 1. Cash

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2. Reduction of premiums—the dividend is used to reduce the next premium coming due.
3. Accumulate at interest—company guarantees a minimum rate on dividend accumulations but may pay a higher rate depending on market conditions.
4. Paid-up additions—the dividend can be used as a single premium to buy additional amounts of paid-up insurance.
5. Term insurance—in some policies, the dividend can be used to purchase term insurance.

C) Other Uses of Dividends

1. Can convert the policy into a paid-up contract
2. Can mature the policy as an endowment

IV. Nonforfeiture Options

A) Cash Value

1. Surrender of the policy for its cash value
2. Little or no cash value during the early years
3. Payment of cash value can be delayed for six months if policy is surrendered (seldom used).

B) Reduced Paid-up Insurance

1. Cash value is used to buy a reduced paid-up policy
2. Appropriate option for someone with limited income who still has some life insurance needs

C) Extended Term Insurance—cash value is used to extend the full face amount of insurance into the future as term insurance for a certain number of years and days.

V. Settlement Options

A) Cash—most proceeds are paid as cash.

B) Interest Option

1. Interest paid to the beneficiary
2. Minimum interest rate guaranteed
3. Beneficiary can make withdrawals.
4. Advantages: flexibility, may allow a change to another option, can be used in a variety of circumstances
5. Main disadvantage: other investments may yield higher return.

C) Fixed Period Option

1. Pays monthly, quarterly, semiannual, or annual payments
2. Death of beneficiary—remaining payments go to a contingent beneficiary or to the estate of primary beneficiary if the beneficiary dies before receiving all payments
3. Uses—where income is needed for a definite period of time, such as the Social Security “black-out” period; readjustment period; family dependency period
4. Limitations—inflexible since partial withdrawals are not allowed

D) Fixed Amount Option

1. Specified amount paid to beneficiary each time period

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2. Advantages: considerable flexibility on withdrawals; may be allowed to change to another option or increase and decrease the fixed amount

E) Life Income Options

1. Life income only
2. Life income with a period certain
3. Life income with refund option
4. Joint-and-survivor life income option

F) Advantages of Settlement Options

1. Periodic income to the family
2. Guaranteed principal and interest
3. Can be useful in life insurance planning
4. Long-term guarantees
5. No additional cost

G) Disadvantages of Settlement Options

1. Higher yields elsewhere
2. Settlement agreement may be inflexible and restrictive.
3. Life income options not attractive at younger ages
4. Insurance windfall can create problems for the beneficiary.

H) Use of a Trust

1. Desirable when the amount of insurance is substantial and judgment in making payouts is required
2. Limitations: expense involved; no guarantee of investment results

VI. Additional Life Insurance Benefits

- A) Waiver-of-Premium
- B) Guaranteed Purchase Option
- C) Double Indemnity Rider
- D) Cost-of-Living Rider
- E) Accelerated Death Benefits Rider