Congratulations! You're here to start an exciting new journey that has the potential to change your family's future!

You took the first step when you joined Primerica. Now, you're here to take the next step: becoming life licensed. Your life license is real, tangible evidence of your desire to make a difference. Having this license gives you a shot at not only creating financial freedom for your family, but it also gives you the chance to change a lot of lives.

As you're going through pre-licensing, I encourage you to think about why you're doing this. Maybe you're here because you want some extra money each month to pay down debt or to boost your savings. Maybe you want to be able to give your kids the things you never had as a child. Maybe you want to make sure no family is left unprotected in the event of the death of a breadwinner.

Whatever your reason for starting this journey, let that be your motivation for passing the exam. Remember, in this business YOU are in control of your future. I believe if you put your mind to it, put in the work and take advantage of the incredible support your upline, Licensing Coach and POL provide, you CAN pass your exam.

Don't worry if it's been a while since you've been in school. We're going to teach you exactly what you'll need in order to get your license and to start making your dreams happen. The rest is up to you.

I believe you've got this! Let's get started!

Glenn Williams
CEO, Primerica

Addendum: for use with Texas Life study guide 22864en_pfs
Exam Outline Update effective 9/1/2019

The following are additions to the existing text:

Chapter V: Texas Statutes and Rules Common to Life and Health Insurance

B. Commissioner of Insurance

2. Investigations, Hearings, and Penalties – *page 95*

Unless the person in violation requests a hearing, emergency cease and desist orders are final **31 days** from the date they are received.

Chapter VI: Texas Statutes and Rules Pertinent to Life Insurance Only

D. Group Life – *page 123*

Only one certificate of insurance is required when delivering a group life policy that includes a statement concerning the coverage of a spouse or children.

Group life insurance policies are prohibited from including any provision that reduces the time period during which an action may be started under the policy to less than **2 years**. Insureds must be allowed to file a lawsuit under the policy within 2 years of a cause of action.

Study on the Go

Insurance Terms to Know

Download MP3 Files to your Mobile Device

Download a QR Code Reader app such as **QR Reader** from the App Store or Google Play Store.

- Open the QR Code Reader
- Center the QR Code in the window and tap/click as directed
- Download the Study on the Go – Insurance Terms to Know mp3 files to your mobile device, following the instructions provided

LIFE
TEXAS

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Published by ExamFX

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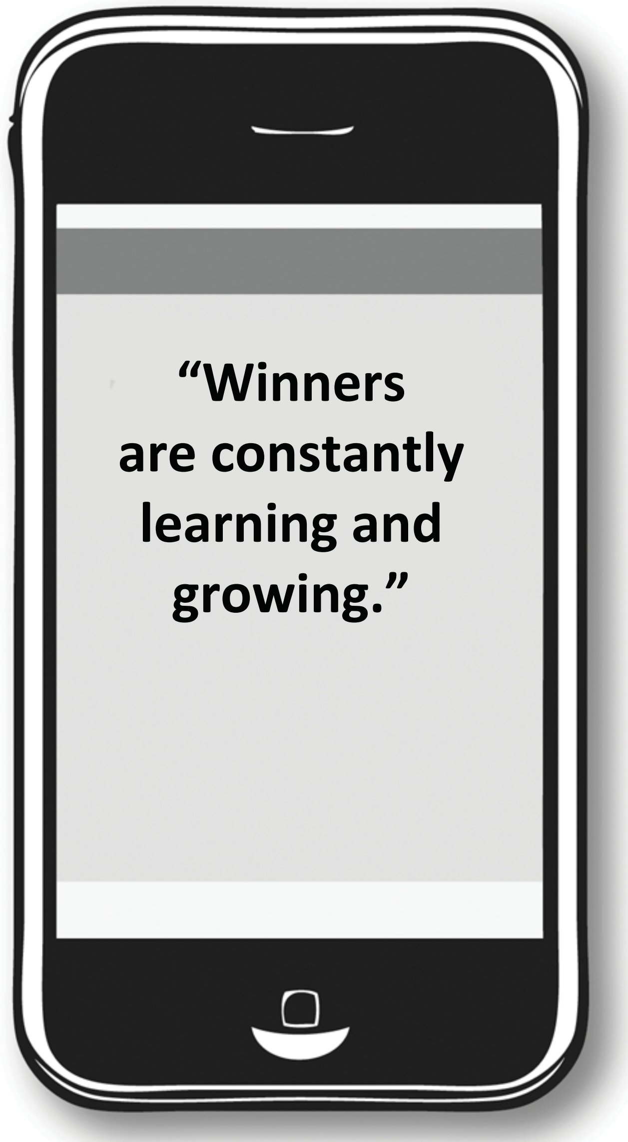
INTRODUCTION



INTRODUCTION

Thank you for choosing the PASS Package. Below you will find useful information about your study materials and passing your actual exam.

A. COURSE DEVELOPMENT

All the study materials in the PASS Package were created solely for your use as you prepare to pass your state licensing exam. We develop our products based on the exam content outlines published by testing providers in each state. Our subject matter experts review the outlines and provide the most up-to-date information that educates students in a streamlined manner, and prepares them for the exam. We work with top instructors and subject-matter experts in the field to ensure that you have access to the most comprehensive study material. Our main goal is to prepare you for the exam and to help you get started on your new career.

B. FEATURES AND BENEFITS

Make use of the features and benefits of the PASS Package products to ensure your success:

- Each chapter introduction outlines the main points you're about to study.
- The *Snapshots* questions in your book provide your first look at the key concepts and allow you to use a focused reading strategy. Answering these questions after you have read the chapter gives you the opportunity to anchor the information in your memory.
- Go over the vocabulary list in *Terms to Know* at the beginning of each chapter to better understand other insurance-specific concepts presented later in the chapter.
- Use *Chapter Recap* for a quick review of key terms and concepts presented in each chapter.
- Test your understanding of key concepts with chapter quizzes.
- Consult the Exam Breakdown in the Introduction to see how each chapter corresponds to the actual exam. A different number of questions is allocated to each chapter, so it is important to focus your time appropriately.
- The information presented in each section is based on the content outlines provided by your state. These outlines detail the topics on which you may be tested on the state exam. Our product presents only the information you will need to study for your exam: nothing more, nothing less.

C. STUDY TIPS

- Always take notes. This will help you to actively engage in the learning process and solidify concepts in your memory.
- If you are studying with the textbook, answer the Snapshot questions at the beginning of each chapter first on your own, and then confirm your answer in the text (the answers are also provided at the end of the Study Guide).
- Make a reference sheet. This will allow you to have a quick focused review at the end of a chapter or the course.
- If you are struggling with some concepts, take an open-book chapter quiz. This will encourage you to seek out answers, analyze information, and apply that knowledge. Once you have to work for it, you will remember and understand the concepts better.

- Take a break from studying. If you have been studying a lot, but feel like you're having trouble remembering the information, take a couple of days off. When you return, Simulate Your Exam and see how you do. Go back and review any areas you have trouble with. Take notes!
- Keep the information fresh in your mind. Study up until the day before your exam. If you are unable to take the state exam right after you have completed your studies, you should re-start the study and review process. It is better to delay taking the exam than to take it unprepared.

D. Test Taking Tips

- Get a good night's sleep. Don't cram right before you take the exam. Arrive at the test center alert and well rested.
- Read the test tutorial carefully and make sure you follow the instructions: Exams may be divided into separate parts; once you've completed one section, you may not be able to go back even for a review.
- Relax. Take deep cleansing breaths and remember it is only a test. If you studied, the correct answers will come to you.
- Read each question and all answer choices thoroughly, but quickly. Do not spend too much time on any one question. If you find yourself stuck on one question for too long, mark it for review on the computer or your paper and move to the next question. Something you answer later may spark your memory. Do not leave any question unanswered!
- Make sure you understand what the question is really asking. Don't let unfamiliar terms throw you off; most of the time they are used only as examples or distracters. Read the question again if needed!
- Eliminate the answers you know are incorrect. Each answer you eliminate increases your chance of choosing the correct answer.
- Go with your first response. If you studied thoroughly, you have all of the answers. Go with your gut instinct and do not overcomplicate the question.
- Pay particular attention to key words that may change the meaning of a question such as NOT, ALL, EXCEPT, EVERY, ALWAYS, or NEVER.
- Know what to expect. All questions are multiple choice and are *generally* one of the following types: direct questions, incomplete sentences, or "all of the following EXCEPT."
- Remember that a little anxiety is good for you! Most people perform better under pressure.

E. About the Exam

Before you take your state exam, you need to prepare yourself not only in terms of studying the material, but also in terms of becoming familiar with test-taking procedures and environment.

A **candidate's handbook or bulletin** for your state provides invaluable information about specific testing procedures, including how to schedule or reschedule your examination, the types of identification you will need, how early to arrive at the testing center, and what you will not be allowed to bring into the testing center. Reading this is an integral part of preparing for your examination. Almost every state offers that information either on the Department of Insurance website or through the testing provider.

Here are more things to know about the testing procedure:

About the Exam	• It will test your knowledge on an *entry-level basis.* • It includes questions about the basics of a large variety of concepts and laws. This program covers all those topics. • Questions on the test are designed to test your basic understanding and retention of the material; they are not trying to trick you. Read questions carefully without reading too much into them. • Review the candidate's handbook or bulletin, or call the testing center to verify specific forms of identification required to be admitted for your state exam.
At the Testing Center	• Arrive at least 30 minutes before the scheduled exam time. • Leave your belongings in the car. Most centers will not allow candidates to take personal items (notebooks, study materials, cell phones, purses, hats, watches, etc.) into the examination site. Some testing centers provide lockers. • Remember, you are not allowed any food, drinks or gum. • Check in at the front desk. • Get comfortable at the desk; adjust the seat and computer monitor as needed. • Before a computer-based exam begins, you will get the opportunity to go through a tutorial to help you learn the specific system used for the test. Take the time to learn how to mark and review answers. • Tune out the rest of the world. Other test takers may come in and leave while you are still working on your exam. Remain focused on what you are doing and do not get distracted by others around you.
Taking the Test	• Most testing centers will provide candidates with scratch paper and a pencil or a dry-erase tablet and markers. • During the test, make notes on more challenging questions to remember what to double check during the review. • During the review, pay special attention to questions you marked, and re-read the rest of the questions to make sure you didn't overlook a familiar concept or a term that changes what the question is asking.

F. Number of Questions on Exam

The Exam Breakdown should be used to see where to focus your valuable study time. Each test is weighted per chapter, so concentrating your efforts will benefit you when taking the actual exam.

Texas Life Insurance Examination
100 Total Questions (85 scored, 15 pretest)

Chapter	Number of Questions on the Exam
GENERAL KNOWLEDGE:	
Completing the Application, Underwriting, and Delivering the Policy	12
Types of Life Policies	12
Life Policy Provisions, Riders and Options	18
Taxes, Retirement, and Other Insurance Concepts	8
STATE LAW:	
Texas Statutes and Rules Common to All Lines	23
Texas Statutes and Rules Pertinent to Life Insurance Only	12

Note that the practice tests and the state exam will be broken into two sections: General Knowledge and State Law; however, you will receive one overall score.

I

COMPLETING THE APPLICATION, UNDERWRITING, AND DELIVERING THE POLICY

I. Completing the Application, Underwriting, and Delivering the Policy

INTRO

Accurate underwriting depends heavily on an application that is complete and representative of the potential risks. This chapter focuses on the producer's first major role as a field underwriter: completing the application and delivering the policy. This section discusses the specific steps of the application process, which includes completing the form itself, collecting the premium, and delivering the policy. In general, this chapter helps you build a foundation of insurance concepts that make it easier for you to master the rest of the material in this course.

SNAPSHOTS

Get direction at the beginning of a chapter. Check out the **Snapshots** before reading the chapter so you can see the whole picture!

1. What is insurance?
2. In a life insurance policy, when must insurable interest exist?
3. What are the four elements of an insurance contract?
4. What does representation mean and how does it differ from a warranty?
5. What does insurance solicitation mean?
6. What information does a Buyer's Guide provide?
7. What is underwriting?
8. What information is gathered in Parts 1 & 2 of the application?
9. What is the purpose of the agent's report?
10. Who is required to sign an application for life insurance?
11. When does an insurance policy go in effect?
12. How can an insurance company use the information it obtains from the MIB?
13. What is the purpose of the Fair Credit Reporting Act?
14. What is the difference between a consumer report and an investigative consumer report?
15. How does a substandard risk policy differ from a standard risk?
16. What are the 3 factors that determine the premium for a particular policy?
17. When is a policy considered delivered?
18. When would an insured be required to sign a statement of good health?

EXAM BREAKDOWN

See where to spend your valuable study time! Check out the **Exam Breakdown** at the beginning for chapter percentages.

TERMS TO KNOW

Adverse selection — insuring of risks that are more prone to losses than the average risk
Agent/Producer — a legal representative of an insurance company; the classification of *producer* usually includes agents and brokers; *agents* are the agents of the insurer
Applicant or proposed insured — a person applying for insurance
Beneficiary — a person who receives the benefits of an insurance policy
Death benefit — the amount paid upon the death of the insured in a life insurance policy
Insurance policy — a contract between a policyowner (and/or insured) and an insurance company which agrees to pay the insured or the beneficiary for loss caused by specific events
Insured — person covered by the insurance policy; may or may not be the policyowner
Insurer (principal) — the company who issues an insurance policy
Lapse — policy termination due to nonpayment of premium
Life insurance — coverage on human lives
Policyowner — the person entitled to exercise the rights and privileges in the policy
Premium — the money paid to the insurance company for the insurance policy

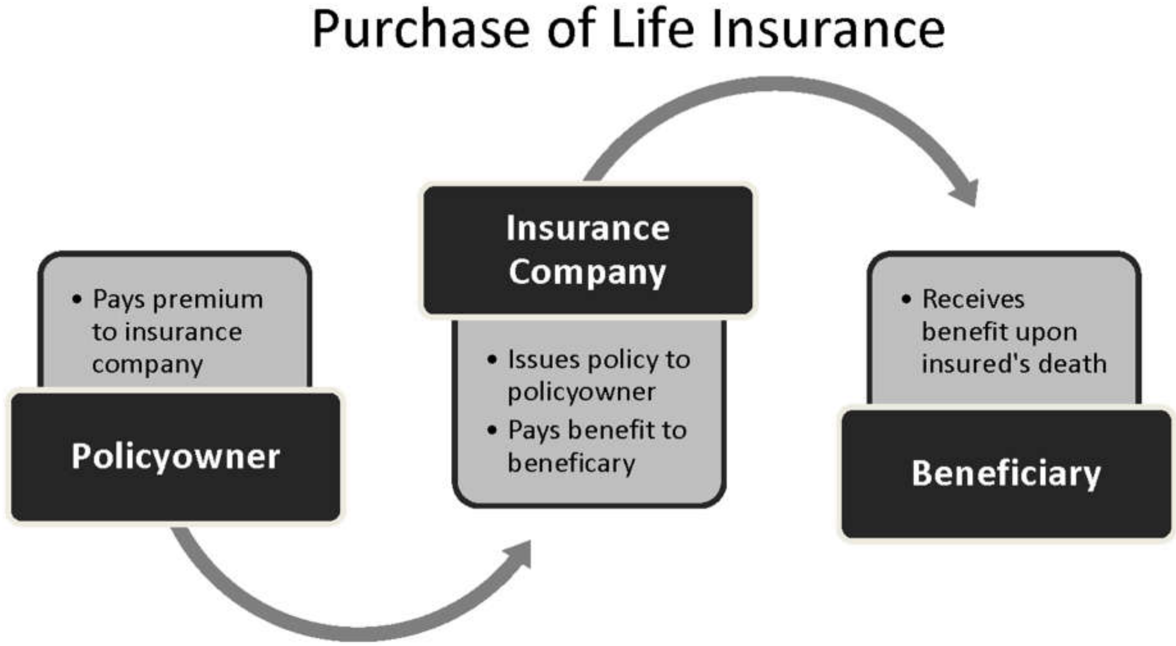
A. Key Concepts/Definitions

Insurance is a contract in which one party (the insurance company) agrees to indemnify (make whole) the insured party against loss, damage or liability arising from an unknown event. In life insurance, the policy protects survivors from losses suffered after an insured's death.

Insurance **transfers** the risk of loss from an individual or business entity to an insurance company, which in turn spreads the costs of unexpected losses to many individuals. If there were no insurance mechanism, the cost of a loss would have to be borne solely by the individual who suffered the loss.

Life insurance protects against financial loss associated with an insured's death, and pays a death benefit to beneficiaries upon the death of the insured. The policyowner of the insurance contract pays a premium to the insurer. The insurer issues a policy covering the insured. In the event of the insured's death, the insurer pays the death benefit to the beneficiary.

Life insurance may be purchased by individuals or businesses.



1. INSURABLE INTEREST

To purchase insurance, the policyowner must face the possibility of losing money or something of value in the event of loss. This is called **insurable interest**. In life insurance, insurable interest must exist between the policyowner and the insured **at the time of application**; however, once a life insurance policy has been issued, the insurer must pay the policy benefit, whether or not an insurable interest exists.

A valid insurable interest may exist between the policyowner and the insured when the policy is insuring any of the following:

1. Policyowner's own life;
2. The life of a family member (a spouse or a close blood relative); or
3. The life of a business partner, key employee, or someone who has a financial obligation to the policyowner (such as debtor to a creditor).

Insurable interest is not required of beneficiaries. Since the beneficiary's well-being is dependent upon the insured, and the beneficiary's life is not the one being insured, the beneficiary does not have to show an insurable interest for a policy to be purchased.

B. CONTRACT LAW

A ***contract*** is an agreement between two or more parties enforceable by law. Because of unique aspects of insurance transactions, the general law of contracts had to be modified to fit the needs of insurance.

1. ELEMENTS OF A LEGAL CONTRACT

In order for insurance contracts to be legally binding, they must have 4 essential elements:

1. Agreement — offer and acceptance;
2. Consideration;
3. Competent parties; and
4. Legal purpose.

Offer and Acceptance

There must be a definite offer by one party, and the other party must accept this offer in its exact terms. In insurance, the applicant usually makes the **offer** when submitting the application. **Acceptance** takes place when an insurer's underwriter approves the application and issues a policy.

Consideration

The binding force in any contract is the **consideration**. Consideration is something of value that each party gives to the other. The consideration on the part of the insured is the payment of premium and the representations made in the application. The consideration on the part of the insurer is the promise to pay in the event of loss.

Competent Parties

The **parties to a contract** must be capable of entering into a contract in the eyes of the law. Generally, this requires that both parties be of legal age, mentally competent to understand the contract, and not under the influence of drugs or alcohol.

Legal Purpose

The purpose of the contract must be **legal** and not against public policy. To ensure legal purpose of a Life Insurance policy, for example, it must have both: insurable interest and consent. A contract without a legal purpose is considered void, and cannot be enforced by any party.

2. Distinct Characteristics of an Insurance Contract

Contract of Adhesion

A ***contract of adhesion*** is prepared by one of the parties (insurer) and accepted or rejected by the other party (insured). Insurance policies are not drawn up through negotiations, and an insured has little to say about its provisions. In other words, insurance contracts are offered on a take-it-or-leave-it basis by an insurer.

Aleatory Contract

Insurance contracts are **aleatory,** which means there is an exchange of unequal amounts or values. The premium paid by the insured is small in relation to the amount that will be paid by the insurer in the event of loss.

<u>Example:</u>

John purchases a life insurance policy for $100,000. His monthly premium is $100. If John only had the policy for 2 months, which means he only paid $200 in premiums, and he unexpectedly died, his beneficiary will receive $100,000. A $200 contribution on the part of the insured in exchange for $100,000 benefit from the insurer illustrates an aleatory contract.

Unilateral Contract

In a **unilateral contract,** only one of the parties to the contract is legally bound to do anything. The insured makes no legally binding promises. However, an insurer is legally bound to pay losses covered by a policy in force.

CONDITIONAL CONTRACT

As the name implies, a **conditional contract** requires that certain conditions must be met by the policyowner and the company in order for the contract to be executed, and before each party fulfills its obligations. *For example*, the insured must pay the premium and provide proof of loss in order for the insurer to cover a claim.

3. REPRESENTATIONS AND WARRANTIES

A **warranty** is an absolutely true statement upon which the validity of the insurance policy depends. Breach of warranties can be considered grounds for voiding the policy or a return of premium. Because of such a strict definition, statements made by applicants for life and health insurance policies, for example, are usually not considered warranties, except in cases of fraud.

Representations are statements believed to be true to the best of one's knowledge, but they are not guaranteed to be true. For insurance purposes, representations are the answers the insured gives to the questions on the insurance application.

Untrue statements on the application are considered **misrepresentations** and could void the contract. A **material misrepresentation** is a statement that, if discovered, would alter the underwriting decision of the insurance company. Furthermore, if material misrepresentations are **intentional**, they are considered fraud.

C. PROCESS OF ISSUING A LIFE INSURANCE POLICY

1. SOLICITATION AND SALES PRESENTATIONS

The process of issuing a life insurance policy begins with solicitation. In simplest terms, *solicitation of insurance* means an attempt to persuade a person to buy an insurance policy, and it can be done orally or in writing. This includes providing information about available products, describing the policy benefits, making recommendations about a specific type of policy, and trying to secure a contract between the applicant and the insurance company.

Any sales presentations used by insurers or their agents in communication with public must be accurate and complete.

Every applicant for a life insurance policy must be given a written disclosure statement that provides basic information about the cost and coverage of the insurance being solicited. This disclosure statement must be given to the applicant no later than the time the application for insurance is signed. Disclosure statements will help the applicants to make more informed and educated decisions about their choice of insurance.

BUYER'S GUIDE

A **buyer's guide** provides basic, **generic** information about life insurance policies that contains, and is limited to, language approved by the Department of Insurance. This document explains how a buyer should go about choosing the amount and type of insurance to buy, and how a buyer can save money by comparing the costs of similar policies. Insurers must provide a buyer's guide to all prospective policy applicants prior to accepting their initial premium. If the policy contains an unconditional refund provision of at least 10 days (free-look period), a buyer's guide can be delivered with the policy.

POLICY SUMMARY

A **policy summary** is a written statement describing the **features and elements** of the policy being issued. It must include the name and address of the agent, the full name and home office or administrative office address of the insurer, and the generic name of the basic policy and each rider. A policy summary will also include premium, cash value, dividend, surrender value and death benefit figures for specific policy years. The policy summary must be provided when the policy is delivered.

2. UNDERWRITING

Underwriting is the risk selection and classification process. It involves a careful analysis of many different factors to determine the acceptability of applicants for insurance. In other words, underwriting is the process in which an insurance company determines whether or not a particular applicant is insurable, and if so, what premium to charge.

The primary criteria an underwriter will use in assessing the desirability of a particular candidate for life insurance are the applicant's health (current and past), occupation, lifestyle, and hobbies or habits. The underwriter will use many different sources of information in determining the insurability of the individual risk.

FIELD UNDERWRITING

The agent is the company's front line, and is referred to as a **field underwriter** because the agent is usually the one who has solicited the potential insured. As a field underwriter, the agent has many important responsibilities during the underwriting process and beyond, including the following:

- Proper solicitation of applicants;
- Helping prevent adverse selection;
- Completing the application;
- Obtaining the required signatures;
- Collecting the initial premium and issuing the receipt, if applicable; and
- Delivering the policy.

APPLICATION

The Application is the starting point and basic source of information used by the company in the risk selection process. Although applications are not uniform and may vary from one insurer to another, they all have the same basic components: Part 1 - General Information and Part 2 - Medical Information.

Part 1 – General Information of the application includes the general questions about the applicant, such as name, age, address, birth date, gender, income, marital status, and occupation. It will also inquire about the existing policies and if the proposed insurance will replace them. Part 1 identifies the type of policy applied for and the amount of coverage, and usually contains information concerning the beneficiary.

Part 2 – Medical Information of the application includes information on the prospective insured's medical background, present health, any medical visits in recent years, medical status of living relatives, and causes of death of deceased relatives. If the amount of insurance is relatively small, the agent and the proposed insured will complete all of the medical information. That would be considered a *nonmedical* application. For larger amounts, the insurer will usually require some sort of medical examination by a professional.

It is the agent's responsibility to make certain that the application is filled out completely, correctly, and to the best of the applicant's knowledge. The agent must probe beyond the stated questions in the application if he or she has any reason to believe the applicant is misrepresenting or concealing information, or does not understand the specific questions asked. Any information that is misleading, inaccurate or illegible may delay the issuance of the policy. If the agent feels that there could be some misrepresentation, he/she must inform the insurance company. Some insurers require that the applicant complete the application under the agent's watchful eye, while other insurers require that the agent complete the application in order to help avoid mistakes and unanswered questions.

AGENT'S REPORT

As a field underwriter, the agent (or producer) can be considered the most important source of information available to the company underwriters. The **agent's report** provides the agent's personal observations concerning the proposed insured. The agent's report does not become a part of the entire contract, although it is a part of the application process.

REQUIRED SIGNATURES

Both the agent and the proposed insured (usually the applicant) must sign the application. If the proposed insured and the policyowner are not the same person, such as a business purchasing insurance on an employee, then the policyowner must also sign the application. An exception to the proposed insured signing the application would be in the case of an adult, such as a parent or guardian, applying for insurance on a minor child.

CHANGES ON THE APPLICATION

When an answer to a question on the application needs to be corrected, agents have the option, depending on which insurer they represent, of correcting the information and having the applicant initial the change, or completing a new application. An agent should never erase or white out any information on an application for insurance.

Consequences of Incomplete Applications

Before a policy is issued, all of the questions on the application must be answered. If the insurer receives an incomplete application, the insurer must return it to the applicant for completion. If a policy is issued with questions left unanswered, the contract will be interpreted as if the insurer waived its right to have an answer to the question. The insurer will not have the right to deny coverage based on any information that the unanswered question might have contained.

Premiums with the Application

Most agents attempt to collect the initial premium and submit it along with the application to the insurer. In addition, collecting the initial premium at the time of the application increases the chance that the applicant will accept the policy once it is issued. Whenever the agent collects premiums, the agent must issue a **premium receipt**. The type of receipt issued will determine when coverage will be effective.

The most common type of receipt is a **conditional receipt**, which is used only when the applicant submits a prepaid application. The conditional receipt says that coverage will be *effective either on the date of the application* or the *date of the medical exam*, whichever occurs last, as long as the applicant is found to be insurable as a standard risk, and policy is issued exactly as applied for. This rule will not apply if a policy is declined, rated, or issued with riders excluding specific coverages.

<u>*Example:*</u>

If an agent collects the initial premium from an applicant and gives the applicant a conditional receipt, and the applicant dies the next day, the underwriting process will proceed as though the applicant were still alive. If the insurer ends up approving the coverage, then the applicant's beneficiary will receive the death benefit of the policy. If, on the other hand, the insurer determines that the applicant was not an acceptable risk and declines the coverage, the premium will be refunded to the beneficiary, and the insurer is not required to pay the death benefit.

Company Underwriting

In order to properly select and classify insurance risks, the insurer needs to obtain the applicants' background information and medical history. There are several sources of underwriting information that are available to the underwriters.

Sources of Underwriting Information

Application

The person applying for insurance must submit an application to the insurer for approval for a policy to be issued. The application is one of the main sources of underwriting information for the company.

Agent's Report

The agent's report allows the agent to communicate with the underwriter and provide information about the applicant known by the agent that may assist in the underwriting process.

MEDICAL EXAMINATIONS

For policies with higher amounts of coverage or if the application raised additional questions concerning the prospective insured's health, the underwriter may require a medical examination of the insured. There are two options, depending on the reason for the medical examination:

1. The insurer may only request a **paramedical report** which is completed by a paramedic or a registered nurse; and
2. The underwriter may require an **Attending Physician's Statement** (APS) from a medical practitioner who treated the applicant for a prior medical problem.

Medical examinations, when required by the insurance company, are conducted by physicians or paramedics at the insurance company's expense. Usually such exams are not required with regard to health insurance, thus stressing the importance of the agent in recording medical information on the application. The medical exam requirement is more common with life insurance underwriting. If an insurer requests a medical examination, the insurer is responsible for the costs of the exam.

It is common among insurers to require an HIV test when an applicant is applying for a large amount of coverage, or for any increased and additional benefits. To ensure proper obtaining and handling of results, and to protect the insured's privacy, states have enacted the following laws and regulations for insurers requiring an applicant to submit to an HIV test:

- The insurer must **disclose the use of testing to the applicant**, and obtain written consent from the applicant on the approved form;
- The insurer must **establish written policies and procedures** for the internal dissemination of test results among its producers and employees to ensure confidentiality.

MEDICAL INFORMATION BUREAU (MIB)

In addition to an attending physician's report, the underwriter will usually request a **Medical Information Bureau (MIB)** report.

The MIB is a membership corporation owned by member insurance companies. It is a **nonprofit trade organization** which receives adverse medical information from insurance companies and maintains confidential medical impairment information on individuals. It is a systematic method for companies to compare the information they have collected on a potential insured with information other insurers may have discovered. The MIB can be used only as an aid in helping insurers know what areas of impairment they might need to investigate further. An applicant cannot be refused simply because of some adverse information discovered through the MIB.

INVESTIGATIVE CONSUMER REPORT (INSPECTION)

To supplement the information on the application, the underwriter may order an inspection report on the applicant from an independent investigating firm or credit agency, which covers financial and moral information. They are general reports of the applicant's finances, character, work, hobbies, and habits. Companies that use inspection reports are subject to the rules and regulations outlined in the Fair Credit Reporting Act.

FAIR CREDIT REPORTING ACT

The **Fair Credit Reporting Act** established procedures that consumer-reporting agencies must follow in order to ensure that records are confidential, accurate, relevant, and properly used. The law also **protects consumers** against the circulation of inaccurate or obsolete personal or financial information.

The acceptability of a risk is determined by checking the individual risk against many factors directly related to the risk's potential for loss. Besides these factors, an underwriter will sometimes request additional information about a particular risk from an outside source. These reports generally fall into 2 categories: Consumer Reports and Investigative Consumer Reports. Both reports can only be used by someone with a legitimate business purpose, including insurance underwriting, employment screening, and credit transactions.

Consumer reports include written and/or oral information regarding a consumer's credit, character, reputation, or habits collected by a reporting agency from employment records, credit reports, and other public sources.

Investigative Consumer Reports are similar to consumer reports in that they also provide information on the consumer's character, reputation, and habits. The primary *difference* is that the information is obtained through an investigation and interviews with associates, friends and neighbors of the consumer. Unlike consumer reports, these reports cannot be made unless the consumer is advised in writing about the report within 3 days of the date the report was requested. The consumers must be advised that they have a right to request additional information concerning the report, and the insurer or reporting agency has 5 days to provide the consumer with the additional information.

The reporting agency and users of the information are subject to civil action for failure to comply with the provisions of the Fair Credit Reporting Act. A person who knowingly and willfully obtains information on a consumer from a consumer reporting agency under false pretenses may also be fined and/or imprisoned for up to 2 years.

An individual who **unknowingly** violates the Fair Credit Reporting Act is liable in the amount equal to the loss to the consumer, as well as any reasonable attorney fees incurred in the process.

An individual who **willfully** violates this Act enough to constitute a general pattern or business practice will be subject to a penalty of up to $2,500.

Under the Fair Credit Reporting Act, if a policy of insurance is declined or modified because of information contained in either a consumer or investigative report, the consumer must be advised and provided with the name and address of the reporting agency. **The consumer has the right to know what was in the report**. The consumer also has a right to know the identity of anyone who has received a copy of the report during the past year. If the consumer challenges any of the information in the report, the reporting agency is required to reinvestigate and amend the report, if warranted. If a report is found to be inaccurate and is corrected, the agency must send the corrected information to all parties to which they had reported the inaccurate information within the last 2 years.

Consumer reports cannot contain certain types of information if the report is requested in connection with a life insurance policy or credit transaction of less than $150,000. The **prohibited information** includes bankruptcies more than 10 years old, civil suits, records of arrest or convictions of crimes, or any other negative information that is more than 7 years old. As defined by the Act, *negative information* includes information regarding a customer's delinquencies, late payments, insolvency or any other form of default.

HIPAA

The Health Insurance Portability and Accountability Act (HIPAA) is a federal law that protects health information. HIPAA regulations provide protection for the privacy of certain *individually identifiable health information (such as demographic data that relates to physical or mental health condition, or payment information that can identify the individual), referred to as* ***protected health information***. Under the **Privacy Rule**, patients have the right to view their own medical records, as well as the right to know who has accessed those records over the previous 6 years. The Privacy Rule, however, allows disclosures without individual authorization to public health authorities authorized by law to collect or receive the information for the purpose of preventing or controlling disease, injury, or disability.

USE AND DISCLOSURE OF INSURANCE INFORMATION

When insurers plan to seek and use information from investigators, they must first provide the applicant/insured with a written Disclosure Authorization Notice. It will state the insurer's practice regarding collection and use of personal information. The disclosure authorization form must be written in plain language, and must be approved by the head of the Department of Insurance.

RISK CLASSIFICATION

In classifying a risk, the Home Office underwriting department will look at the applicant's past medical history, present physical condition, occupation, habits and morals. If the applicant is acceptable, the underwriter must then determine the risk or **rating classification** to be used in deciding whether or not the applicant should pay a higher or lower premium. A prospective insured may be rated as one of the three classifications: **standard, substandard,** or **preferred.**

STANDARD

Standard risks are persons who, according to a company's underwriting standards, are entitled to insurance protection without extra rating or special restrictions. Standard risks are representative of the majority of people at their age and with similar lifestyles. They are the average risk.

PREFERRED

Preferred risks are those individuals who meet certain requirements and qualify for lower premiums than the standard risk. These applicants have a superior physical condition, lifestyle, and habits.

SUBSTANDARD

Substandard (High Exposure) risk applicants are not acceptable at standard rates because of physical condition, personal or family history of disease, occupation, or dangerous habits. These policies are also referred to as "rated" because they could be issued with the **premium rated-up**, resulting in a higher premium.

Applicants who are rejected are considered **declined risks**. Risks that the underwriters assess as not insurable are declined. *For example*, a risk may be declined for one of the following reasons:

- There is no insurable interest;
- The applicant is medically unacceptable;
- The potential for loss is so great it does not meet the definition of insurance; or
- Insurance is prohibited by public policy or is illegal.

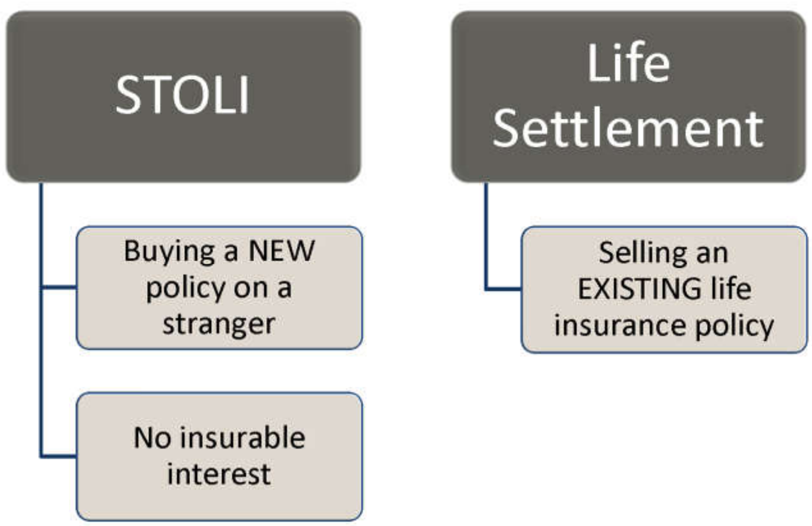
Stranger-originated Life Insurance (STOLI) and Investor-originated Life Insurance (IOLI)

Stranger-originated life insurance (STOLI) is a life insurance arrangement in which a person with no relationship to the insured (a "stranger") purchases a life policy on the insured's life with the intent of selling the policy to an investor and profiting financially when the insured dies. In other words, STOLIs are financed and purchased solely with the intent of selling them for life settlements.

STOLIs **violate the principle of insurable interest**, which is in place to ensure that a person purchasing a life insurance policy is actually interested in the longevity rather than the death of the insured. Because of this, insurers take an aggressive legal stance against policies they suspect are involved in STOLI transactions.

Note that lawful life settlement contracts do not constitute STOLIs. Life settlement transactions result from existing life insurance policies; STOLIs are initiated for the purpose of obtaining a policy that would benefit a person who has no insurable interest in the life of the insured at the time of policy origination.

Investor-owned life insurance (IOLI) is another name for a STOLI, where a third-party **investor who has no insurable interest in the insured** initiates a transaction designed to transfer the policy ownership rights to someone with no insurable interest in the insured and who hopes to make a profit upon the death of the insured or annuitant.



3. Premium Determination

Once the company determines that an applicant is insurable, they need to establish an appropriate policy premium. The premium will be used to cover the costs and expenses to keep the policy in force. **Premiums are paid in advance**.

Factors in Premium Determination

There are three primary factors that are used in premium determination: risk (mortality - rate of death within a specific group), interest and expense.

Premium Payment Mode

In regards to insurance premiums, *mode* refers to the **frequency** the policyowner pays the premium. An insurance policy's rates are based on the assumption that the premium will be paid annually at the beginning of the policy year and that the company will have the premium to invest for a full year before paying any claims. If the policyowner chooses to pay the premium more frequently than annually, there will be an additional charge because the company will have additional expenses in billing the premium. However, the premium may be paid annually, semi-annually, quarterly, or monthly.

Higher Frequency = Higher Premium

Monthly > Quarterly > Semiannual > Annual

If the insured dies during a period of time for which the premium has been paid, the insurer must **refund any unearned premium** along with the policy proceeds.

4. Policy Issue and Delivery

Once the underwriting process has been completed and the company issues the policy, the agent will deliver it to the insured. Although personal delivery of the insurance policy is the best method of finalizing the insurance transaction, mailing the policy directly to the policyowner is acceptable. When the insurer relinquishes control of the policy by mailing it to the policyowner, policy is considered legally delivered. However, it is advisable to obtain a signed **delivery receipt**.

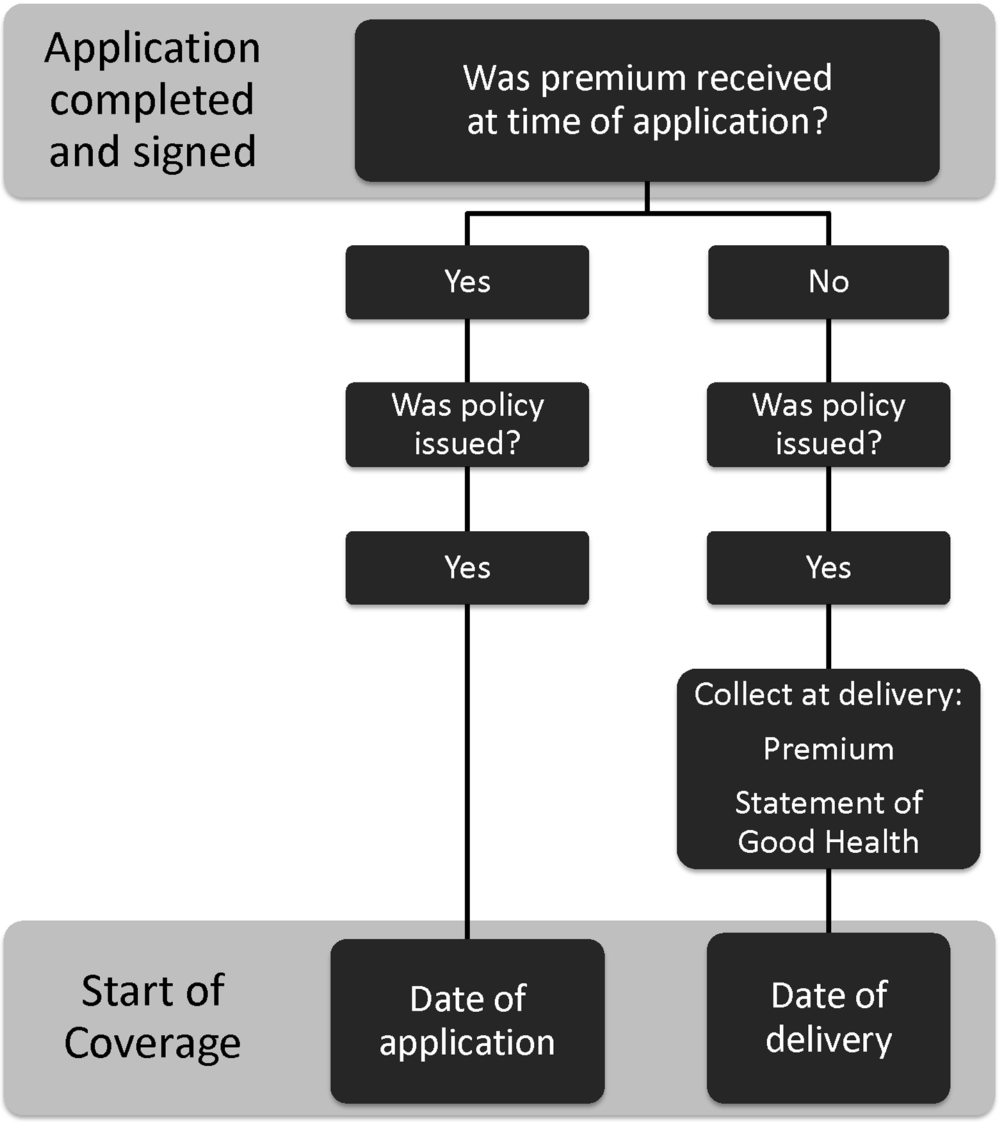
Explaining the Policy

Personal delivery of the policy allows the agent an opportunity to make sure that the insured understands all aspects of the contract. Review of the contract with the insured involves pointing out provisions or riders that may be different than anticipated, and explaining what effect they have on the contract. In addition, the agent should explain the rating procedure to the client, especially if the policy is **rated differently** than applied for, or has been modified or amended in any other way. The agent should also explain any other choices and provisions available to the policyowner that may become active at this time.

Effective Date of Coverage

If the initial premium is not paid with the application, the agent will be required to collect the premium at the time of policy delivery. In this case, the policy does not go into effect until the premium has been collected. The agent may also be required to get a **statement of good health** from the insured. This statement must be signed by the insured, and verifies that the insured has not suffered injury or illness since the application date.

If the full premium was submitted with the application and the policy was issued as requested, the policy coverage would generally coincide with the date of application.



D. Policy Replacement

Replacement is a practice of terminating an existing policy or letting it lapse, and obtaining a new one. To make sure that replacement is appropriate and in the best interests of the policyowner, insurance producers and companies must take special underwriting measures to help policyowners make informed decisions.

E. USA PATRIOT Act/Anti-Money Laundering

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act, also known as the **USA PATRIOT Act** was enacted on October 26, 2001. The purpose of the Act is to address social, economic, and global initiatives to fight and prevent terrorist activities. The Act enabled the Financial Crime Enforcement Network (FinCEN) to require banks, broker-dealers, and other financial institutions to establish new **anti-money laundering (AML)** standards. With new rules in place, FinCEN incorporated the insurance industry into this group.

To secure the goals of the Act, FinCEN has implemented an AML Program that requires the monitoring of all financial transactions and reporting of any suspicious activity to the government, along with prohibiting correspondent accounts with foreign shell banks. A comprehensive customer identification and verification procedure is also to be set in place. The AML program consists of the following minimum requirements:

- Assimilate policies, procedures and internal controls based on an in-house risk assessment, including:
  - Instituting AML programs similar to banks and securities lenders; and
  - File suspicious activity reports (SAR) with Federal authorities;
- Appointing a qualified compliance officer responsible for administering the AML program;
- Continual training for applicable employees, producers and other; and
- Allow for independent testing of the program on a regular basis.

1. Suspicious Activity Reports (SARs) Rules

Any company that is subject to the AML Program is also subject to SAR rules. SAR rules state that procedures and plans must be in place and designed to identify activity that one would deem suspicious of money laundering, terrorist financing and/or other illegal activities. Deposits, withdrawals, transfers or any other business deals involving $5,000 or more are required to be reported if the financial company or insurer "knows, suspects or has reason to suspect" that the transaction:

- Has no business or lawful purpose;
- Is designed to deliberately misstate other reporting constraints;
- Uses the financial institution or insurer to assist in criminal activity;
- Is obtained using fraudulent funds from illegal activities; or
- Is intended to mask funds from other illegal activities.

Some "red flags" to look for in suspicious activity:

- Customer uses fake ID or changes a transaction after learning that he or she must show ID;
- Two or more customers use similar IDs;
- Customer conducts transactions so that they fall just below amounts that require reporting or recordkeeping;
- Two or more customers seem to be working together to break one transaction into two or more (trying to evade the Bank Secrecy Act (BSA) requirements); or
- Customer uses two or more money service business (MSB) locations or cashiers on the same day to break one transaction into smaller transactions (trying to evade BSA requirements).

Relevant SAR reports must be filed with FinCEN within 30 days of initial discovery. Reporting takes place on FinCEN Form 108.

F. Chapter Recap

Make sure you review the following key terms before moving on to the next chapter:

Basic Concepts	Insurance Insurable interest Material misrepresentation Representation Warranty
Insurance Contracts	Adhesion Aleatory Competent parties Conditional Consideration Legal purpose Offer and acceptance Unilateral

Underwriting	Application
	Agent's report
	Attending physician's statement
	Conditional receipt
	Consumer report
	Field underwriting
	Investigative consumer report
	Medical Information Bureau
	Classification of Risks:
	  Preferred
	  Standard
	  Substandard
	Premium:
	  Mortality, Interest, Expense
	  Mode
	STOLI/IOLI

Policy Issue and Delivery	Statement of Good Health Replacement

This chapter explained some of the basic principles and processes of life insurance underwriting. Let's recap them:

GENERAL CONCEPTS	
Insurance	• Transfers the risk of loss from an individual to an insurer • Based on the principle of indemnity • Based on the spreading of risk (risk pooling) and the law of large numbers
Insurable Interest	• Must exist at the time of application • Insuring one's own life, family member, or a business partner
INSURANCE CONTRACTS	
Elements of a Legal Contract	• *Agreement* - offer and acceptance • *Consideration* - premiums and representations on the part of the insured; payment of claims on the part of the insurer • *Competent parties* - of legal age, sound mental capacity, and not under the influence of drugs or alcohol • *Legal purpose* - not against public policy
Contract Characteristics	• *Adhesion* - one party prepares the contract; the other party must accept it as is • *Aleatory* - exchange of unequal amounts • *Conditional* - certain conditions must be met • *Unilateral* - only one of the parties to the contract is legally bound to do anything
PROCESS OF ISSUING A LIFE INSURANCE POLICY	
Underwriting	Field Underwriting (by agent) • *Application* - completed and signed • *Agent's report* - agent's observations about the applicant that can assist in underwriting • Premiums with application and conditional receipts Company Underwriting • Multiple sources of information: application, consumer reports, MIB • *Risk classification* - 3 types of risks: standard, substandard, preferred Federal Regulations • Fair Credit Reporting Act: protects consumers against circulation of inaccurate or obsolete information • USA PATRIOT Act/Anti-money Laundering and Suspicious Activity Reports Rules
Premium Determination	• 3 key factors for life insurance: mortality, interest, and expense • *Mode* - the more frequently premium is paid, the higher the premium
Policy Issue and Delivery	• *Effective date of coverage* - if the premium is not paid with the application, the agent must obtain the premium and a statement of continued good health at the time of policy delivery

G. Chapter Quiz - Completing the Application, Underwriting, and Delivering the Policy

1. Which of the following is considered a field underwriter?

A. An agent
B. An insurer
C. An adjuster
D. A company underwriter

2. When must insurable interest exist in life insurance?

A. Death of the insured
B. Policy delivery date
C. Time of claim
D. Application date

3. If no receipt is issued at the time of application, a statement of good health is usually required at the time of

A. Application.
B. Policy delivery.
C. Policy renewal.
D. The paramedic's report.

4. The Medical Information Bureau is

A. A government entity that reviews medical information.
B. An association of physicians who write insurance rules.
C. A directory of paramedical services and providers.
D. A source of medical information to alert insurers to adverse medical history.

5. In an insurance contract, consideration refers to

A. A legal capacity.
B. Exchange of something of value by both parties.
C. Abiding by the laws of ethics.
D. An act by one party in exchange for a promise by the other.

6. Over several years, a policyowner paid $10,000 in premiums for his insurance policy. When he suffered a loss, the insurance company paid out $50,000 in benefits. What characteristic of an insurance contract does this describe?

A. Unilateral
B. Adhesion
C. Conditional
D. Aleatory

7. All the following may have an insurable interest in the insured EXCEPT

A. The spouse.
B. Insured's children.
C. The employer.
D. Insured's best friend.

8. Which of the following would be the main source of underwriting information used by the company in the risk selection process?

A. Application
B. Warranty
C. MIB report
D. Attending physician's statement

9. An insured submits the full premium along with a completed application, and the policy is issued 10 days later. When does the coverage begin?

A. When the policy is received
B. After the free-look period
C. On the date of the application
D. On the date the policy is issued

10. What is the main responsibility of a company's underwriting unit?

A. Controlling business written by new agents
B. Marketing and solicitation of insurance
C. Issuing policies
D. Risk selection and classification

11. Which of the following best describes the purpose of the USA PATRIOT Act with regards to the insurance industry?

A. To provide insurance to military service men and women and their dependents
B. To protect the public from the internal and external terror threats
C. To prevent terrorism activities through monitoring of financial transactions
D. To protect insurance companies from insurance fraud

12. If the agent feels that there could be misrepresentation on the part of the applicant for insurance, what must the agent do?

A. Inform the insurance company
B. Change the applicant's answer to what the agent knows is true
C. Erase the answer once the applicant submits the application
D. Refuse the applicant

13. Representations are statements made by the applicant that are

A. Considered true to the best of the applicant's knowledge.
B. Guaranteed to be true.
C. Found to be false after further investigation.
D. Immaterial to the actual acceptability of the insurance contract.

14. If an agent fails to obtain an applicant's signature on the insurance application, the agent must

A. Return the application to the applicant for signature.
B. Send the application to the insurer with a note explaining the absence of signature.
C. Sign the application for the applicant.
D. Sign the application as an agent, stating that all the answers have been verified.

15. Which of the following includes information regarding a person's credit, character, reputation, and habits?

A. Agent's report
B. MIB report
C. Consumer report
D. Fair Credit report

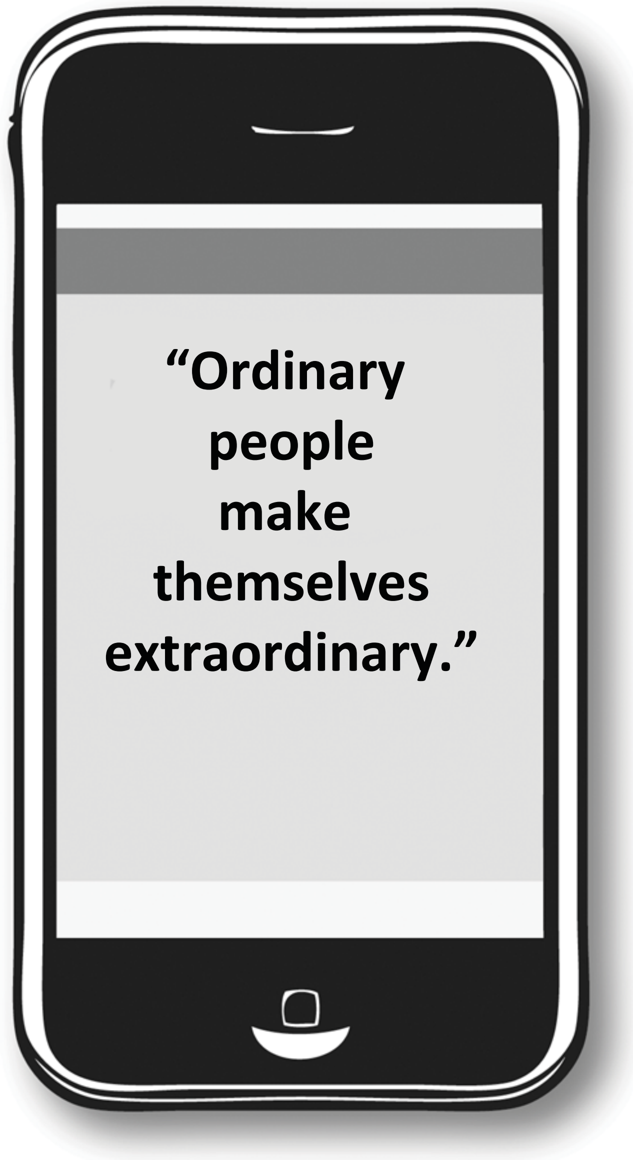
Answers to the quiz may be found in Appendix A.

FLASHBACK

Test your retention of the new concepts you learned. **Flashback** to the beginning of the chapter to review the **Snapshots** before moving forward.

II

TYPES OF LIFE POLICIES



II. Types of Life Policies

INTRO

This chapter teaches you about the major types of life insurance policies, their characteristics and functions, and who is best served by each type. This chapter also includes a discussion about annuities. It teaches you about the parties to the annuity, and annuity periods, and how to recognize different classifications of annuities.

SNAPSHOTS

1. What are the characteristics of term life insurance?
2. What is annually renewable term insurance?
3. What are the characteristics of whole life insurance?
4. How does continuous premium straight life differ from 20-year limited pay life?
5. What are the death benefit options in universal life policies?
6. Which authorities regulate variable life policies?
7. What qualifications must an individual obtain prior to selling variable life insurance products?
8. How do annuities differ from life insurance policies?
9. Who has all of the rights in an annuity contract?
10. What happens to the benefit if the annuitant dies during the accumulation period?
11. An annuity has 2 distinct periods. What are they called, and what happens during each?
12. What are the 2 premium payment options in annuities?
13. How does inflation affect the purchasing power of a fixed annuity?
14. How soon can payments begin in a deferred annuity?

EXAM BREAKDOWN

See where to spend your valuable study time! Check out the **Exam Breakdown** at the beginning for chapter percentages.

TERMS TO KNOW

Attained age — the insured's age at the time the policy is issued or renewed
Cash value — a policy's savings element or living benefit
Face amount — the amount of benefit stated in the life insurance policy
Fixed life insurance — contracts that offer guaranteed minimum or fixed benefits
Deferred — withheld or postponed until a specified time or event in the future
Endow — the cash value of a whole life policy has reached the contractual face amount
Level premium — the premium that does not change throughout the life of a policy
Liquidation of an estate — converting a person's net worth into a cash flow
Nonforfeiture values — benefits in a life insurance policy that the policyowner cannot lose even if the policy is surrendered or lapses
Policy maturity — in life policies, the time when the face value is paid out
Qualified plan — a retirement plan that meets IRS guidelines for receiving favorable tax treatment
Securities — financial instruments that may trade for value (for example, stocks, bonds, options)
Suitability — a requirement to determine if an insurance product is appropriate for a customer
Variable life insurance — contracts in which the cash values accumulate based upon a specific portfolio of stocks without guarantees of performance

There are many types of life insurance products available for consumers. Although all life insurance products offer death protection, each type also includes its own unique features and benefits and is designed to serve different insureds' needs.

Regarding the length of coverage, all life insurance policies fall into 2 categories: temporary and permanent protection.

A. TERM LIFE INSURANCE

Term insurance is *temporary* protection because it only provides coverage for a specific period of time. It is also known as pure life insurance. Term policies provide for the greatest amount of coverage for the lowest premium as compared to any other form of protection. There is usually a maximum age above which coverage will not be offered or at which coverage cannot be renewed.

Term insurance provides what is known as **pure death protection**:

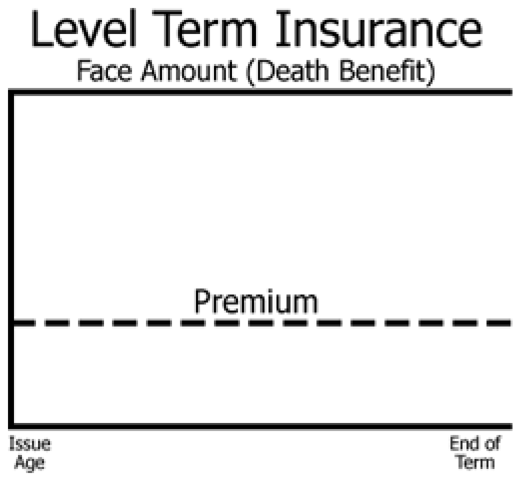
- If the insured dies during this term, the policy pays the death benefit to the beneficiary;
- If the policy is canceled or expires prior to the insured's death, nothing is payable at the end of the term; and
- There is no cash value or other living benefits.

There are three basic types of term coverage available, based on **how the face amount (death benefit) changes** during the policy term:

- Level;
- Increasing; and
- Decreasing.

Regardless of the type of term insurance purchased, the premium is level throughout the term of the policy; only the amount of the death benefit may fluctuate, depending on the type of term insurance. Upon selling, renewing, or converting the term policy, the premium is figured at attained age (the insured's age at the time of transaction).

1. Level Term

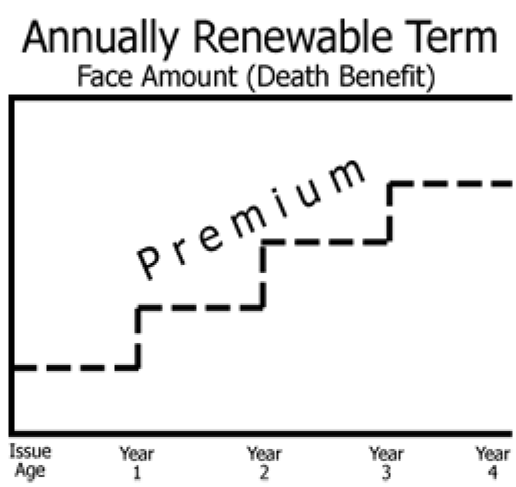


Level term insurance is the most common type of temporary protection purchased. The word *level* refers to the death benefit that does not change throughout the life of the policy.

Level Premium Term

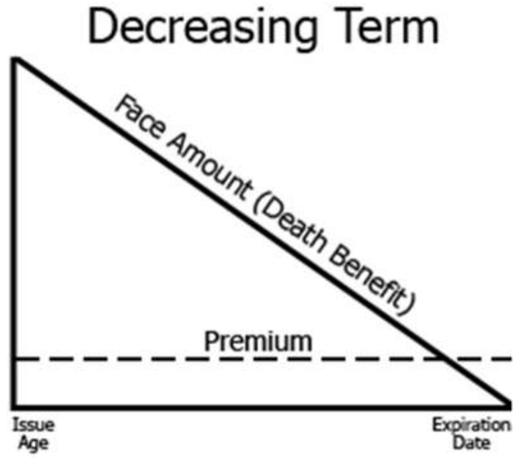
Level premium term, as the name implies, provides a level death benefit and a level premium during the policy term. *For example,* a $100,000 10-year level term policy will provide a $100,000 death benefit if the insured dies any time during the 10-year period. The premium will remain level during the entire 10-year period. If the policy renews at the end of the 10-year period, the premium will be based on the insured's attained age at the time of renewal.

Annually Renewable Term



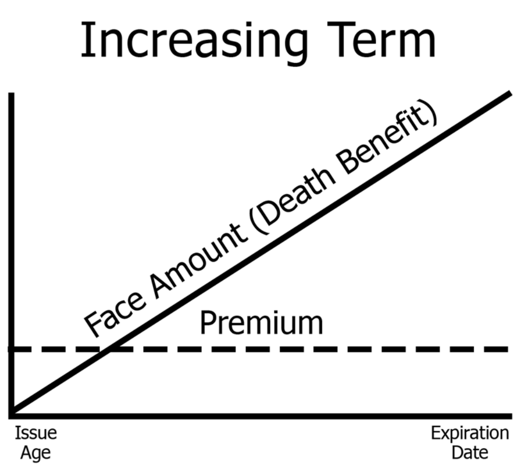
Annually renewable term (ART) is the purest form of term insurance. The death benefit remains level (in that sense, it's a level term policy), and the policy may be guaranteed to be renewable each year without proof of insurability, but the premium increases annually according to the attained age, as the probability of death increases.

2. Decreasing Term



Decreasing term policies feature a level premium and a death benefit that decreases each year over the duration of the policy term. Decreasing term is primarily used when the amount of needed protection is time sensitive, or decreases over time. Decreasing term coverage is commonly purchased to insure the payment of a **mortgage or other debts** if the insured dies prematurely. The amount of coverage thereby decreases as the outstanding loan balance decreases each year. A decreasing term policy is usually convertible; however, it is usually not renewable since the death benefit is $0 at the end of the policy term.

3. Increasing Term



Increasing term features level premiums and a death benefit that increases each year over the duration of the policy term. The amount of the increase in the death benefit is usually expressed as a specific amount or a percentage of the original amount. Increasing term is often used by insurance companies to fund certain riders that provide a *refund of premiums* or a gradual increase in total coverage, such as the cost of living or return of premium riders.

This type of policy would be ideal to handle inflation and the increasing cost of living. It is also often added to another policy as a rider, such as with return of premium policies.

4. Return of Premium

Return of premium (ROP) life insurance is an *increasing term* insurance policy that pays an additional death benefit to the beneficiary equal to the amount of the premiums paid. The return of premium is paid if the death occurs within a specified period of time or if the insured outlives the policy term.

ROP policies are structured to consider the low risk factor of a term policy but at a significant increase in premium cost, sometimes as much as 25% to 50% more. Traditional term policies offer a low-cost, simple-death benefit for a specified term but have no investment component or cash value. When the term is over, the policy expires and the insured is without coverage. An ROP policy offers the pure protection of a term policy, but if the insured remains healthy and is still alive once the term limit expires, the insurance company guarantees a return of premium. However, since the amount returned equals the amount paid in, the returned premiums are not taxable.

Example:

A healthy, 30-year old male pays $380 annually for a $250,000, 30-year term policy. At the end of the 30 years, he has paid a total of $11,400 in premiums which will be returned to him if he is still alive. The insurance company has determined that $250 per year, or $7,500 over 30 years, will cover the actual cost of protection. The excess funds, which the insurer invests, provide the cash for the returned premiums.

5. Special Features: Renewable and Convertible

Most term insurance policies are renewable, convertible, or renewable and convertible (R&C).

The **renewable** provision allows the policyowner the right to renew the coverage at the expiration date *without evidence of insurability*. The premium for the new term policy will be based on the insured's current age. *For example*, a 10-year term policy that is renewable can be renewed at the end of the 10-year period for a subsequent 10-year period without evidence of insurability. However, the insured will have to pay the premium that is based on his or her attained age. If an individual purchases a 10-year term policy at age 35, he or she will pay a premium based on the age of 45 upon renewing the policy.

The **convertible** provision provides the policyowner with the right to convert the policy to a permanent insurance policy *without evidence of insurability*. The premium will be based on the insured's attained age at the time of conversion.

B. Traditional Whole Life Insurance

Permanent life insurance is a general term used to refer to various forms of life insurance policies that build cash value and remain in effect for the entire life of the insured (or until age 100) as long as the premium is paid. The most common type of permanent insurance is whole life.

Whole life insurance provides lifetime protection, and includes a savings element (or cash value). Whole life policies endow at the insured's **age 100**, which means the cash value created by the accumulation of premium is scheduled to equal the face amount of the policy at age 100. The policy premium is calculated assuming that the policyowner will be paying the premium until that age. Premiums for whole life policies usually are higher than for term insurance.

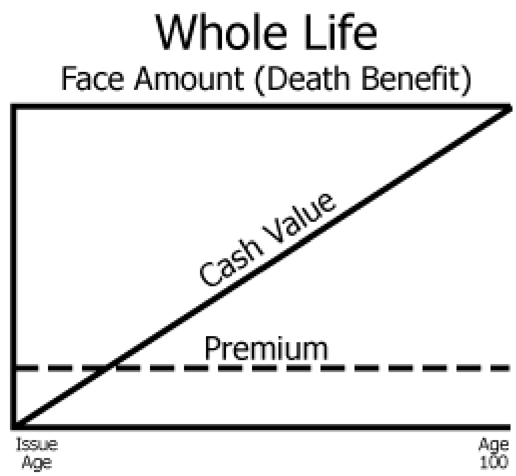
The following are key characteristics of whole life insurance.

- **Level premium:** the premium for whole life policies is based on the issue age; therefore, it remains the same throughout the life of the policy.
- **Death benefit:** the death benefit is guaranteed and also remains level for life.

- **Cash value:** the cash value, created by the accumulation of premium, is scheduled to equal the face amount of the policy when the insured reaches age 100 (the policy maturity date), and is paid out to the policyowner. (Remember: the insured and the policyowner do not have to be the same person.) Cash values are credited to the policy on a regular basis and have a guaranteed interest rate.
- **Living benefits:** the policyowner can borrow against the cash value while the policy is in effect, or can receive the cash value when the policy is surrendered. The cash value, also called nonforfeiture value, does not usually accumulate until the third policy year and it grows tax deferred.

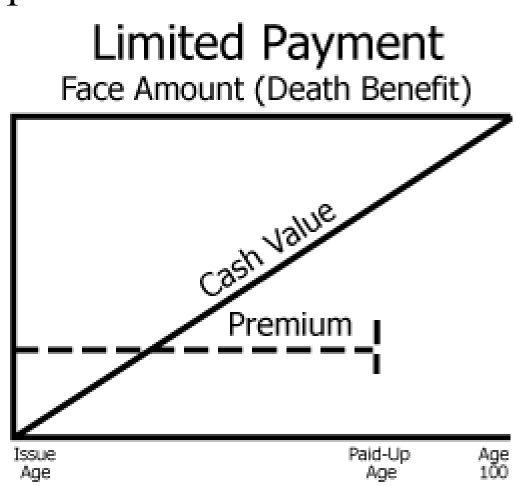
The three basic forms of whole life insurance are straight whole life, limited-pay whole life and single premium whole life; however, other forms and combination plans may also be available.

1. Ordinary Whole Life



Straight life (also referred to as *ordinary life* or *continuous premium whole life*) is the basic whole life policy (illustrated above). The policyowner pays the premium from the time the policy is issued until the insured's death or age 100 (whichever occurs first). Of the common whole life policies, straight life will have the lowest annual premium.

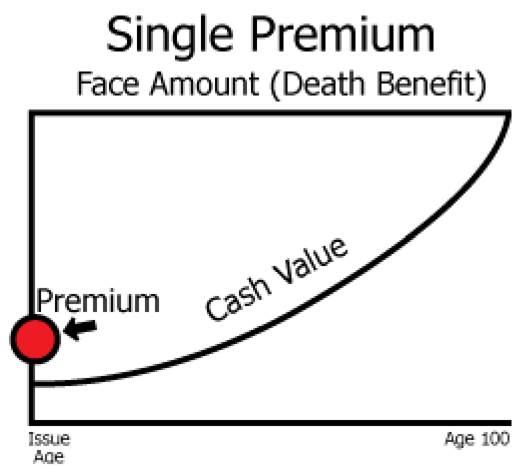
2. Limited Payment



Unlike straight life, limited-pay whole life is designed so that the premiums for coverage will be completely paid-up well before age 100. Some of the more common versions of limited-pay life are 20-pay life whereby coverage is completely paid for in 20 years, and life paid-up at 65 (LP-65) whereby the coverage is completely paid up for by the insured's age 65. All other factors being equal, this type of policy has a shorter premium-paying period than straight life insurance, so the annual premium will be higher. Cash value builds up faster for the limited-pay policies.

Limited-pay policies are well suited for those insureds who do not want to be paying premiums beyond a certain point in time. *For example*, an individual may need some protection after retirement, but does not want to be paying premiums at that time. A limited-pay (paid-up at 65) policy purchased during the person's working years will accomplish that objective.

3. Single Premium



Single premium whole life (SPWL) is designed to provide a level death benefit to the insured's age 100 for a one-time, lump-sum payment. The policy is completely paid-up after one premium and generates immediate cash.

	TERM LIFE	WHOLE LIFE
Type of protection	Temporary	Permanent until age 100
Premium	Level	Level
Death benefit	• Level • Increasing • Decreasing	Level
Living benefits	Not available	• Cash values • Policy loans • Nonforfeiture values

C. Interest/Market-sensitive/Adjustable Life Products

There are several other types of whole life policies. While they all have the same key characteristics, they may also offer unique features based on how the policyowner pays the premium or how the premium is invested. Flexible premium policies allow the policyowner to pay more or less than the planned premium.

1. ADJUSTABLE LIFE

Adjustable life was developed in an effort to provide the policyowner with the best of both worlds (term and permanent coverage). An adjustable life policy can assume the form of either term insurance or permanent insurance. The insured typically determines how much coverage is needed and the affordable amount of premium. The insurer will then determine the appropriate type of insurance to meet the insured's needs. As the insured's needs change, the policyowner can make adjustments in his or her policy. Typically, the policyowner has the following options:

- Increase or decrease the premium or the premium-paying period;
- Increase or decrease the face amount; or
- Change the period of protection.

The policyowner also has the option of **converting** from term to whole life or vice versa. However, increases in the death benefit or changing to a lower premium type of policy will usually require proof of insurability. In the case of converting from a whole life policy to a term policy, the insurer may adjust the death benefit. The policyowner may also pay additional premiums above and beyond what is required under the permanent form in order to accumulate greater cash value or to shorten the premium paying-period.

Although adjustable life policies contain most of the common features of other whole life policies, the **cash value** of an adjustable life policy only develops when the premiums paid are more than the cost of the policy.

2. UNIVERSAL LIFE

Universal life insurance is also known by the generic name of *flexible premium adjustable life*. That implies that the policyowner has the flexibility to increase the amount of premium paid into the policy and to later decrease it again. In fact, the policyowner may even skip paying a premium and the policy will not lapse as long as there is sufficient cash value at the time to cover the monthly deductions for cost of insurance. If the cash value is too small, the policy will expire.

Since the premium can be adjusted, the insurance companies may give the policyowner a choice to pay either of the two types of premiums:

- The **minimum premium** is the amount needed to keep the policy in force for the current year. Paying the minimum premium will make the policy perform as an annually renewable term product.
- The **target premium** is a recommended amount that should be paid on a policy in order to cover the cost of insurance protection and to keep the policy in force throughout its lifetime.

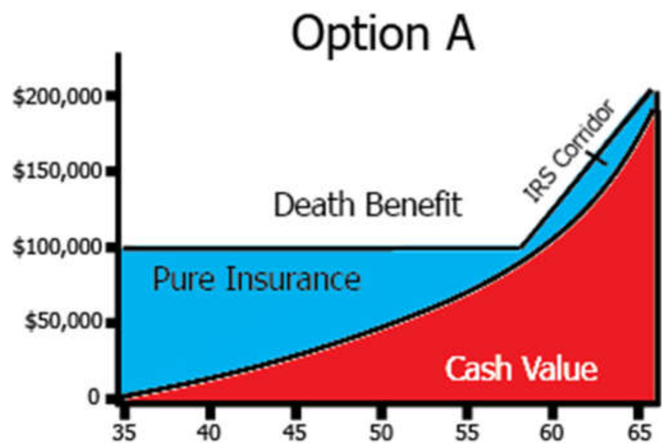
As well as being a flexible premium policy, universal life is also an interest-sensitive policy. Although the insurer guarantees a **contract interest rate** (usually 3 to 6%), there is also potential for the policyowner to get a **current interest rate**, which is not guaranteed in the contract but may be higher because of current market conditions.

A universal life policy has two components: an **insurance component** and a **cash account**. The insurance component of a universal life policy is always **annually renewable term insurance**.

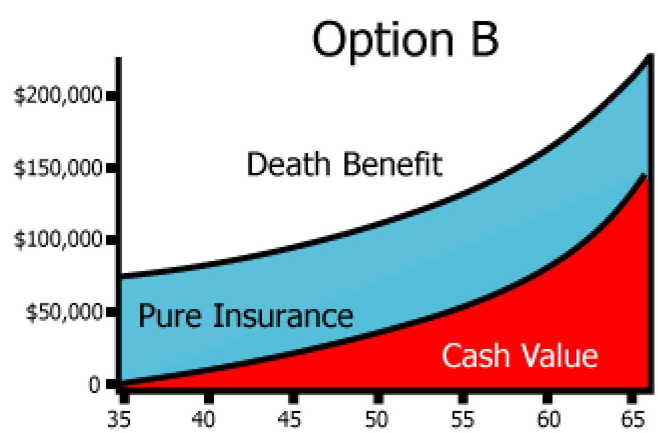
Universal life policies allow the **partial withdrawal** (partial **surrender**) of the policy cash value. However, there may be a charge for each withdrawal and there are usually limits as to how much and how often a withdrawal may be made. During the withdrawal, the interest earned on the withdrawn cash value may be subject to taxation, depending upon the plan. The death benefit will be reduced by the amount of any partial surrender. Note, however, that a partial surrender from a universal life policy is not the same as a policy loan.

DEATH BENEFIT OPTIONS

Universal life offers one of two death benefit options to the policyowner. **Option A** is the *level death benefit* option, and **Option B** is the *increasing death benefit* option.



Under **Option A (Level Death Benefit option)**, the death benefit remains level while the cash value gradually increases, thereby lowering the *pure insurance* with the insurer in the later years. Notice that the pure insurance is actually decreasing as time passes, lowering the expenses, and allowing for greater cash value in the older years. The reason that the illustration shows an increase in the death benefit at a later point in time is so that the policy will comply with the "statutory definition of life insurance" that was established by the IRS and applies to all life insurance contracts issued after December 31, 1984. According to this definition, there must be a specified "corridor" or gap maintained between the cash value and the death benefit in a life insurance policy. The percentages that apply to the corridor are established in a table published by the IRS and vary as to the age of the insured and the amount of coverage. If this corridor is not maintained, the policy is no longer defined as life insurance for tax purposes and consequently loses most of the tax advantages that have been associated with life insurance.



Under **Option B (Increasing Death Benefit option)**, the death benefit includes the annual increase in cash value so that the death benefit gradually increases each year by the amount that the cash value increases. At any point in time, the total death benefit will always be equal to the face amount of the policy plus the current amount of cash value. Since the *pure insurance* with the insurer remains level for life, the expenses of this option are much greater than those for Option A, thereby causing the cash value to be lower in the older years (all else being equal).

3. Variable Whole Life

Variable life insurance (sometimes referred to as *variable whole life insurance*) is a level, fixed premium, investment-based product. Like traditional forms of life insurance, these policies have fixed premiums and a guaranteed minimum death benefit. The cash value of the policy, however, is not guaranteed and fluctuates with the performance of the portfolio in which the premiums have been invested by the insurer. The policyowner bears the investment risk in variable contracts.

Because the insurance company is not sustaining the investment risk of the contract, the underlying assets of the contract cannot be kept in the insurance company's general account. These assets must be held in a **separate account**, which invests in stocks, bonds, and other securities investment options. Any domestic insurer issuing variable contracts must establish one or more separate accounts. Each separate account must maintain assets with a value at least equal to the reserves and other contract liabilities.

4. Variable Universal Life

Variable universal life insurance is a type of insurance that combines many features of the whole life with the flexible premium of universal life and the investment component of variable life, making it a securities version of the universal life insurance.

Variable universal life insurance, like universal life itself, has the following features and characteristics:

- A flexible premium that can be increased, decreased or skipped as long as there is enough value in the policy to fund the death benefit;
- Increasing and decreasing the amount of insurance; and
- Cash withdrawals or policy loans.

Unlike universal life, most of the investment vehicles in variable universal life policies do not guarantee return.

Variable life insurance products are **dually regulated** by the State and Federal Government. Due to the element of investment risk, the federal government has declared that variable contracts are **securities**, and are thus regulated by the Securities and Exchange Commission (SEC), and the Financial Industry Regulatory Authority (FINRA), formerly known as the National Association of Securities Dealers (NASD). Variable life insurance is also regulated by the Insurance Department as an insurance product.

Agents selling variable life insurance products must:

- Be registered with FINRA;
- Have a securities license; and
- Be licensed by the state to sell life insurance.

5. Interest-Sensitive Whole Life

Interest-sensitive whole life, also referred to as **current assumption** life, is a whole life policy that provides a guaranteed death benefit to age 100. The insurer sets the initial premium based on current assumptions about risk, interest and expense. If the actual values change, the company will lower or raise the premium at designated intervals. In addition, interest-sensitive whole life policies credit the cash value with the current interest rate that is usually comparable to money market rates, and can be higher than the guaranteed levels. The policy also provides for a minimum guaranteed rate of interest.

Interest-sensitive whole life provides the same benefits as other traditional whole life policies with the added benefit of current interest rates, which may allow for either greater cash value accumulation or a shorter premium-paying period.

6. Indexed Life

The main feature of **indexed whole life** (or equity index whole life) insurance is that the cash value is dependent upon the performance of the equity index, such as S&P 500 although there is a guaranteed minimum interest rate. The policy's face amount increases annually to keep pace with inflation (as the Consumer Price Index increases) without requiring evidence of insurability. Indexed whole life policies are classified depending on whether the policyowner or the insurer assumes the inflation risk. If the policyowner assumes the risk, the policy premiums increase with the increases in the face amount. If the insurer assumes the risk, the premium remains level.

	Adjustable Life	**Universal Life**	**Variable Life**
Key Features	Can be Term or Whole Life; Can convert from one to the other	Permanent insurance with renewable Term protection component	Permanent insurance
Premium	Can be increased or decreased by policyowner	Flexible; Minimum or target	Fixed (if Whole Life); Flexible (if Universal Life)
Face Amount	Flexible: set by policyowner with proof of insurability		Can increase or decrease to a stated minimum
Cash Value	Fixed rate of return; General account	Guaranteed at a minimum level; General Account	Not guaranteed; Separate Account
Policy Loans	Can borrow cash value		

D. Combination Plans and Variations

1. Joint Life

Joint life is a single policy that is designed to insure two or more lives. Joint life policies can be in the form of term insurance or permanent insurance. The premium for joint life would be less than for the same type and amount of coverage on the same individuals. It is more commonly found as *joint whole life*, which functions similarly to an individual whole life policy with two major exceptions:

- The premium is based on a **joint average age** that is between the ages of the insureds.
- The death benefit is paid upon the **first death only**.

A premium based on joint age is less than the sum of 2 premiums based on individual age, so it is common to find joint life policies issued on husbands and wives. This is particularly so if the need for insurance is such that it does not extend beyond the first death. Joint life policies are used when there is a need for two or more persons to be protected; however, the need for the insurance is no longer present after the first of the insureds dies.

For example, a married couple purchasing a house may use a Joint Life policy for mortgage protection if both spouses work and earn close to the same amount of income. If one spouse dies, the insurance pays the mortgage for the surviving spouse.

Joint Life is also used to insure the lives of business partners in the funding of a buy-sell agreement and other business life needs. A buy-sell is a business continuation agreement that determines what will be done with the business in the event that an owner dies or becomes disabled.

2. Survivorship Life (Second to Die)

Survivorship life (also referred to as "second-to-die" or "last survivor" policy) is much the same as joint life in that it insures two or more lives for a **premium that is based on a joint age**. The major difference is that survivorship life **pays on the last death** rather than upon the first death. Since the death benefit is not paid until the last death, the joint life expectancy in a sense is extended, resulting in a lower premium than that which is typically charged for joint life, which pays upon the first death. This type of policy is often used to **offset the liability of the estate tax** upon the death of the last insured.

E. Annuities

1. Annuity Principles and Concepts

An **annuity** is a contract that provides income for a specified period of years, or for life. An annuity protects a person against outliving his or her money. Annuities are not life insurance, but rather a vehicle for the accumulation of money and the **liquidation of an estate**. Annuities are marketed by life insurance companies. Licensed life insurance agents are authorized to sell some types of annuities.

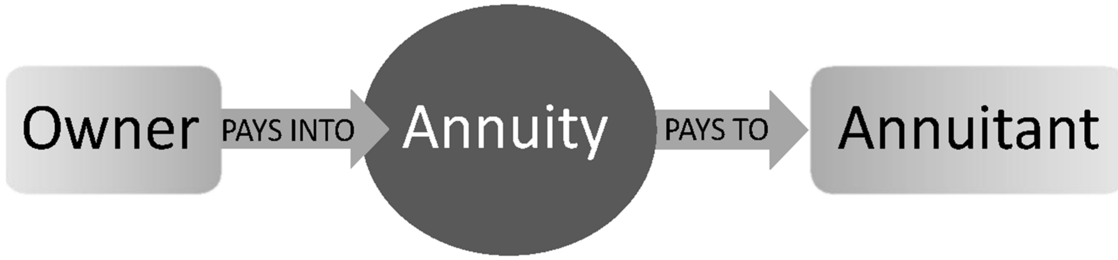
Annuities do not pay a face amount upon the death of the annuitant. In fact, they do just the opposite. In most cases, the payments stop upon the death of the annuitant. Annuities use *mortality tables*, but these tables reflect a longer life expectancy than the mortality tables used for life insurance. *Mortality tables* indicate the number of individuals within a specified group (e.g. males, females, smokers, nonsmokers) starting at a certain age, who are expected to be alive at a succeeding age.

The Parties

Owner — The purchaser of the annuity contract, but not necessarily the one who receives the benefits. **The owner of the annuity has all of the rights,** such as naming the beneficiary and surrendering the annuity. The owner of an annuity may be a corporation, trust, or other legal entity.

Annuitant — The person who receives benefits or payments from the annuity, whose life expectancy is taken into consideration, and for whom the annuity is written. The annuitant and the contract owner do not need to be the same person, but most often are. A corporation, trust or other legal entity may own an annuity, but the **annuitant must be a natural person**.

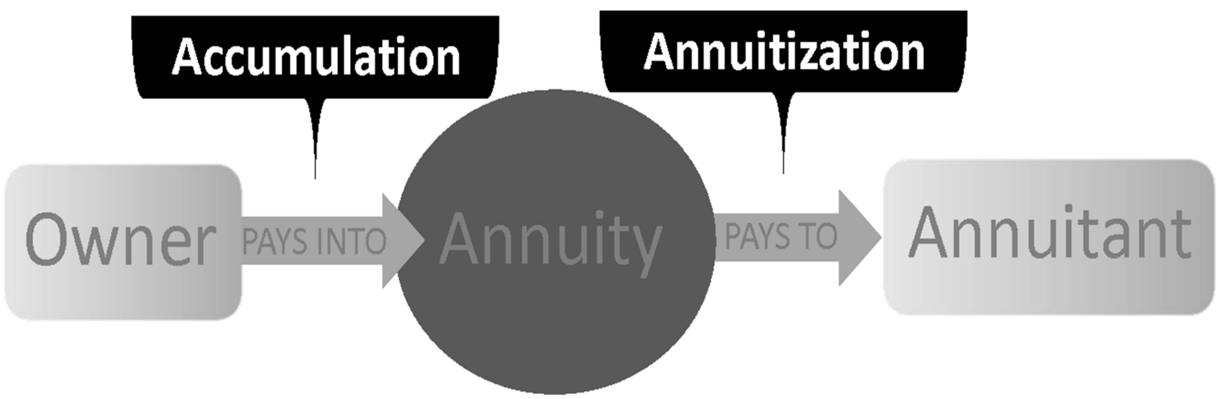
Beneficiary — The person who receives annuity assets (either the amount paid into the annuity or the cash value, whichever is greater) if the annuitant dies during the accumulation period, or to whom the balance of annuity benefits is paid out.



ACCUMULATION PERIOD VS. ANNUITY PERIOD

The **accumulation period**, also known as the **pay-in period**, is the period of time over which the owner makes payments (premiums) into an annuity. Furthermore, it is the period of time during which the payments earn interest on a tax-deferred basis.

The **annuity period**, also known as the **annuitization period**, **liquidation period**, or **pay-out period,** is the time during which the sum that has been accumulated during the accumulation period is converted into a stream of income payments to the annuitant. The annuity period may last for the lifetime of the annuitant or for a specified period, which could be longer or shorter. The *annuitization date* is the time when the annuity benefit payouts begin (trigger for benefits).



The annuity income amount is based upon the following:

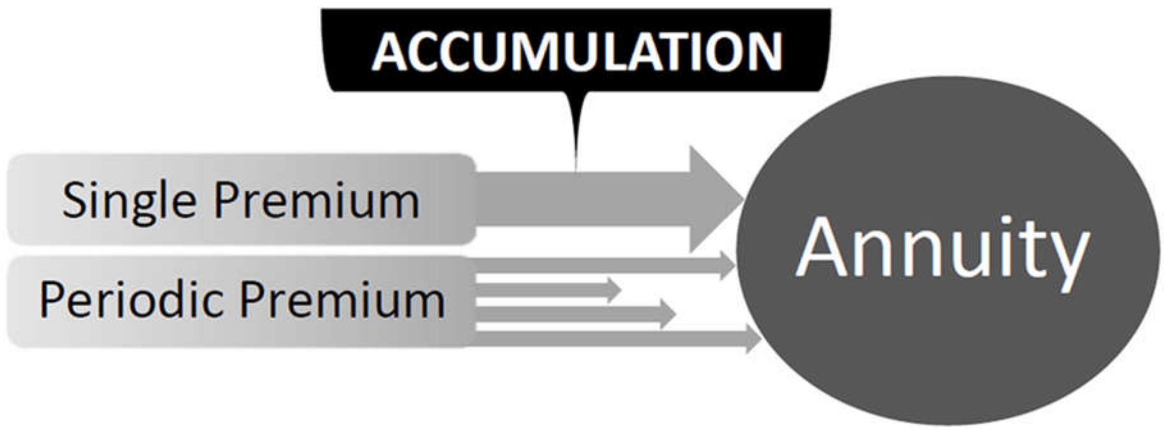
- The amount of premium paid or cash value accumulated;
- The frequency of the payment;
- The interest rate; and
- The annuitant's age and gender.

An annuitant whose life expectancy is longer will have smaller income installments. *For example,* all other factors being equal, a 65-year-old male will have higher annuity income payments than a 45-year-old male (because he is younger), or than a 65-year-old female (because women statistically have a longer life expectancy).

2. Types of Annuities

Annuities can be classified according to how premiums are paid into the annuity, how premiums are invested, and when and how benefits are paid out.

Premium Payment Options



The first way to classify annuities can be based on how they can be funded (paid for). There are 2 options: a **single premium** (one-time lump-sum payment) or through **periodic payments** in which the premiums are paid in installments over a period of time. Periodic payment annuities can be either **level premium**, in which the annuitant/owner pays a fixed installment, or **flexible premium**, in which the amount and frequency of each installment varies.

Annuity Investment Options

Annuities may be classified as fixed or variable based on how the premium payments are invested.

Fixed Annuities

A **fixed annuity** provides the following features:

- Guaranteed minimum rate of interest to be credited to the purchase payment(s);
- Income (annuity) payments that do not vary from one payment to the next;
- The insurance company guarantees the specified dollar amount for each payment and the length of the period of payments as determined by the settlement option chosen by the annuitant.

With fixed annuities, the annuitant knows the exact amount of each payment received from the annuity during the annuity period. This is called **level benefit payment amount**. A disadvantage to fixed annuities is that the purchasing power that they afford may be eroded over time due to inflation.

VARIABLE ANNUITIES

A **variable annuity** serves as a hedge against inflation, and is variable from the standpoint that the annuitant may receive different rates of return on the funds that are paid into the annuity. Listed below are the 3 main characteristics of variable annuities:

- **Underlying Investment:** the payments that the annuitant makes into the variable annuity are invested in the insurer's separate account, not their general account. The separate account is not part of the insurance company's own investment portfolio, and is not subject to the restrictions that are applicable to the insurer's own general account.
- **Interest Rate:** issuing insurance company does not guarantee a minimum interest rate.
- **License Requirements:** a variable annuity is considered a **security** and is regulated by the Securities Exchange Commission (SEC) in addition to state insurance regulations. An agent selling variable annuities must hold a securities license in addition to a life insurance license. Agents or companies that sell variable annuities must also be properly registered with FINRA.

Variable premiums purchase **accumulation units** in the fund, which is similar to buying shares in a Mutual Fund. Accumulation units represent ownership interest in the separate account. Upon annuitization, the accumulation units are converted to **annuity units**. The income is then paid to the annuitant based on the value of the annuity units. The number of annuity units received remains level, but the unit values will fluctuate until actually paid out to the annuitant.

FEATURES	FIXED ANNUITY	VARIABLE ANNUITY
Interest Rate	Guaranteed by insurer	No guarantee
Underlying Investment	General account (safe, conservative)	Separate account (equities, no guarantee)
License Needed	Life insurance	Life insurance PLUS securities
Expenses	Guaranteed	Guaranteed
Income Payment	Guaranteed	No guarantee

INDEXED ANNUITIES

Indexed (or equity indexed) annuities are fixed annuities that invest on a relatively aggressive basis to aim for higher returns. Like a fixed annuity, the indexed annuity has a guaranteed minimum interest rate. The current interest rate that is actually credited is often tied to a familiar index like the Standard and Poor's 500.

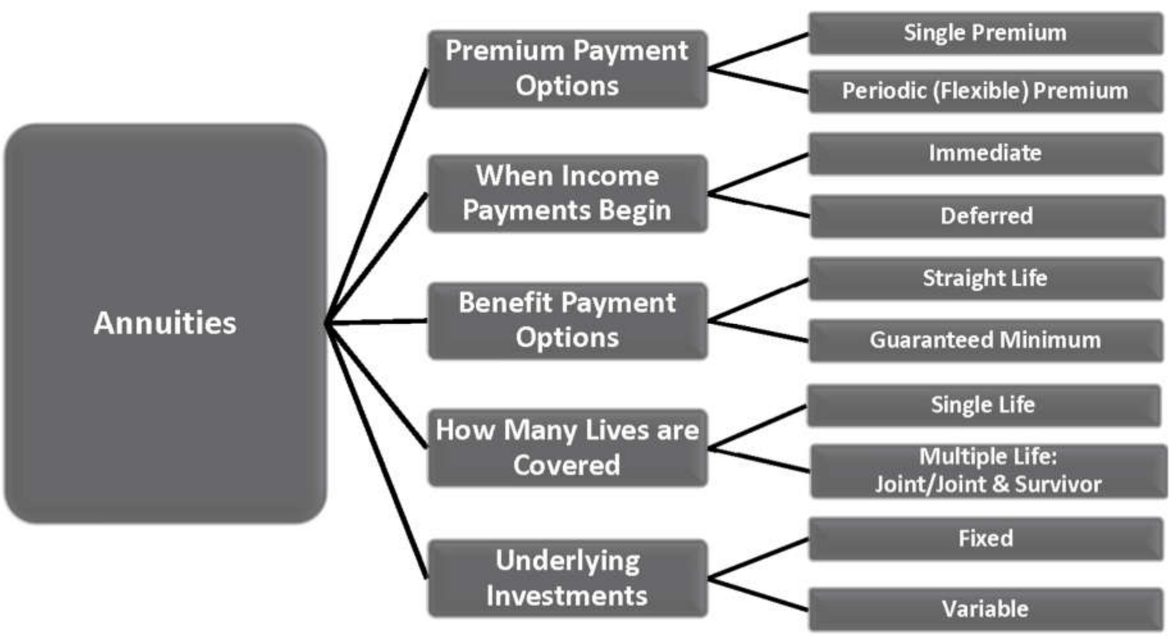
Generally, the insurance companies reserve the initial returns for themselves but pay the excess to the annuitant. *For example*, the company may keep the first 4% earned for itself, but any accumulation in excess of 4% is credited to the annuitant's account. So if the interest earned is 12%, the company keeps 4% and credits the client's account with 8%.

Equity indexed annuities are less risky than a variable annuity or mutual fund but are expected to earn a higher interest rate than a fixed annuity.

IMMEDIATE VS. DEFERRED ANNUITIES

Annuities can also be classified according to when the income payments from the annuity begin. An **immediate annuity** is one that is purchased with a single, lump-sum payment and provides income payments that start **within one year** from the date of purchase. Typically, an immediate annuity will make the first payment as early as 1 month from the purchase date. Most commonly, this type of annuity is known as a Single Premium Immediate Annuity (SPIA).

A **deferred annuity** is an annuity in which the income payments begin sometime **after one year** from the date of purchase. Deferred annuities can be funded with either a single lump sum (Single Premium Deferred Annuities — SPDAs) or through periodic payments (Flexible Premium Deferred Annuities — FPDAs). Periodic payments can vary from year to year. The longer the annuity is deferred, the more flexibility for payment of premiums it allows.



3. USES OF ANNUITIES

The principal use of an annuity is to provide income for **retirement**; however, an annuity may be used for any accumulation of cash or simply to liquidate an estate. Because of the various uses of annuities, agents should always assess how well a recommended product will meet the applicant's needs and resources — the **suitability** of a product.

It is a producer's responsibility to evaluate the consumer's suitability information, which includes the following:

- Age;
- Income;
- Financial situation and financial experience;
- Needs and objectives;
- Intended use of annuity;
- Risk tolerance; and
- Tax status.

LUMP-SUM SETTLEMENT

Annuities may serve as an ideal financial vehicle for someone who comes into a large lump sum of money, such as inheritance, lottery, award of damages from a lawsuit, proceeds from a sale of a business, or a lump-sum distribution from a qualified pension plan. In this case, a person may purchase a single premium immediate annuity, which will convert the lump sum into a series of periodic payments, providing a stream of income for the annuitant.

QUALIFIED RETIREMENT PLANS

Since annuities are a popular means to provide retirement income, they are often used to fund **qualified retirement plans**, which means they meet the IRS guidelines to receive favorable tax treatment.

Qualified retirement annuities can be **individual** (such as individual retirement accounts - IRAs), and **group** (such as tax-sheltered annuity - TSA, or profit-sharing pension plans).

EDUCATION FUNDS

In addition to providing income for retirement and estate liquidation, annuities can be used to accumulate funds for college education. An annuity can provide savings on a tax-deferred basis for the education expenses of the annuitant.

F. CHAPTER RECAP

CHAPTER RECAP

Make sure you review the following key terms before moving on to the next chapter:

Types of Insurance	Term/Temporary Permanent/Whole Life
Types of Term Policies	Level Term Annually Renewable Term Decreasing Term Increasing Term
Whole Life Insurance	Ordinary Life Limited Payment Single Premium

Interest-sensitive Life Products	Indexed Life
	Interest-sensitive Whole Life
	Universal Life
	  Option A
	  Option B
	Variable Life Insurance
	Variable Universal Life Insurance

Other Policies	Joint life Survivorship life
Basic Annuity Terms	Annuity Annuitant Accumulation/Pay-in period Annuitization/liquidation/pay-out period Beneficiary Owner
Types of Annuities	Deferred annuity Fixed annuity General account Immediate annuity Indexed annuity Separate account Variable annuity

This chapter was full of information about different types of life insurance policies and annuities. Make sure you know all of the types of policies discussed, and can recognize their major characteristics, as well as compare and contrast different types of policies. Let's recap all of these concepts.

TERM LIFE	
General characteristics	• Pure protection • Lasts for specific term • No cash value
Level Premium Term	Level death benefit and level premium
Annually Renewable Term	• Renews each year without proof of insurability • Premiums increase due to attained age
Decreasing Term	Coverage gradually decreases at predetermined times; best used when the need for protection declines from year to year
Features of Term Policies	• *Renewable* - renew the policy without evidence of insurability • *Convertible* - right to convert a term policy to a permanent policy without evidence of insurability
WHOLE LIFE	
General characteristics	• Permanent protection • Guaranteed elements (face amount, premium, and cash value) until death or age 100 • Level premium • Cash value and other living benefits
Ordinary Whole Life (Continuous Premium)	• Basic policy • Level death benefit • Insured pays premiums for life or until age 100

Limited Payment	Premiums paid until a certain time; coverage in effect to age 100
Single Premium	Premiums paid in one lump sum; coverage continues to age 100
FLEXIBLE PREMIUM	
General characteristics	• Types of whole life insurance • Flexible premium
Universal Life	• An insurance component in the form of annually renewable term • 2 death benefit options: *Option A* - level death benefit, and *Option B* - increasing death benefit • Can make partial surrender/cash withdrawal
OTHER TYPES OF POLICIES	
Variable Life	• Fixed premium, minimum death benefit • Cash value and the actual amount of death benefit are not guaranteed • Assets in separate accounts • Agents must be dually licensed in insurance and in securities
Combination Plans	• *Joint Life:* - Premium is based on the joint average age of the insured - Death benefit upon the first death only • *Survivorship Life:* - Premium is based on the joint average age of the insured - Death benefit upon the last death
ANNUITIES	
Phases	• *Accumulation (pay-in)* - payments made into the annuity • *Annuitization (pay-out)* - payments made to the annuitant from the annuity
Parties	• *Annuitant* - insured (must be a person); policy issued on annuitant's life • *Beneficiary* - will receive any amount contributed to annuity (plus any gain) if annuitant dies during accumulation period • *Owner* - has all rights to policy (usually annuitant); can be corporation or trust
Types of Annuities	• *Fixed annuities* - guaranteed, fixed payment amount; premiums in general account • *Variable annuities* - payment not guaranteed; premiums in separate account, and invested in stocks and bonds • *Indexed annuities* - interest rate tied to an index; earn higher rate than fixed annuities, not as risky as variable annuities or mutual funds
Premium Payments	• *Single premium* - ONE lump-sum payment; the principal is created immediately (both immediate and deferred annuities) • *Periodic (Flexible) premium* - multiple payments; the principal is created over time (used for deferred annuity only)
Income Payments	• *Immediate* - purchased with a single premium; income payments start within 12 months from the date of purchase • *Deferred* - purchased with either lump sum or periodic-payments premium; benefits start sometime after 1 year from the date of purchase (often used to accumulate funds for retirement)

G. CHAPTER QUIZ - TYPES OF LIFE POLICIES

1. When the insured purchased a new home, he wanted to purchase a life insurance policy that would protect his family against losing it should he die before the mortgage was paid. Which of the following policies is best suitable for that need?

A. Whole life
B. Level term
C. Decreasing term
D. Return of premium

2. An annually renewable term policy

A. Increases in premium based on the insured's health.
B. Maintains a level premium each year.
C. Renews each year with an increased premium.
D. Increases in coverage each year.

3. The time period during which an annuitant contributes to an annuity is called

A. The annuity period.
B. The accumulation period.
C. The deferred growth.
D. The savings period.

4. Which of the following is an example of a limited-pay life policy?

A. Straight life
B. Life paid-up at age 65
C. Renewable term to age 70
D. Endowment maturing at age 65

5. Which of the following features of the Indexed Whole Life policy is NOT fixed?

A. Premium
B. Death benefit
C. Policy period
D. Cash value growth

6. Which of the following statements is true regarding a universal life policy?

A. The insurer sets the cash value and premium payment period.
B. The death benefit can be increased without evidence of insurability.
C. The premiums can be decreased by the insured.
D. It is issued without a guaranteed interest rate.

7. With a traditional whole life policy, the death benefit

A. Remains constant over time.
B. Increases over time.
C. Decreases over time.
D. Becomes pure death protection after 20 years.

8. Whose life expectancy is taken into consideration in an annuity?

A. Owner
B. Annuitant
C. Beneficiary
D. Life expectancy is not a factor in annuities.

9. An insured receives a monthly summary of his life insurance policy. The cash value this month is significantly lower than it was last month. What type of policy is it?

A. Adjustable
B. Variable
C. Term
D. Whole life

10. An individual inherited a large sum of money at age 40 and wanted to use it to provide a guaranteed income after his retirement at age 60. Which of the following types of annuities would best meet this need?

A. Immediate
B. Flexible premium
C. Deferred
D. Variable

11. Which of the following would be considered a disadvantage of term insurance?

A. If the insured dies during the term, the policy pays only the accumulated cash value.
B. If the insured dies after the end of the term, there is no death benefit to the beneficiary.
C. The policy provides the smallest amount of coverage for the highest premium.
D. It cannot be renewed or converted to a permanent policy.

12. The renewable provision allows the policyowner to renew the coverage at the expiration date

A. Without evidence of insurability.
B. Only with evidence of insurability.
C. With evidence of insurability if the insurer requires it.
D. With evidence of insurability if the insured risk has increased.

13. Which type of life insurance policy generates immediate cash value?

A. Single premium
B. Level term
C. Variable life
D. Decreasing term

14. Which of the following is true regarding a joint life policy?

A. It pays a death benefit after the last insured's death.
B. Premium is based on the average age of the insureds.
C. It is a form of group life insurance.
D. It is used to offset the liability of the estate tax upon the insured's death.

15. The insured is also the policyowner of a whole life policy. What age must the insured attain in order to receive the policy's face amount?

A. 62
B. 70 1/2
C. 95
D. 100

Answers to the quiz may be found in Appendix A.

FLASHBACK

Test your retention of the new concepts you learned. **Flashback** to the beginning of the chapter to review the **Snapshots** before moving forward.

III

LIFE POLICY PROVISIONS, RIDERS AND OPTIONS

III. LIFE POLICY PROVISIONS, RIDERS, AND OPTIONS

INTRO

By this point, you should have a solid working knowledge of the different types of life insurance policies and their suitability for different types of insured individuals. Now you will learn about available provisions, riders, and options that can make two policies of the same type different in significant ways.

Provisions define the characteristics of an insurance contract and are fairly universal from one policy to the next. **Riders** are added to a policy to modify provisions that already exist. **Options** offer insurers and insureds ways to invest or distribute a sum of money available in a life policy. It is essential for you to have a good understanding of the different provisions, riders, and options for future life insurance transactions.

SNAPSHOTS

1. What constitutes the entire contract?
2. What is the free-look period, and when does it begin?
3. What is the difference between absolute and collateral assignment?
4. What is the purpose of a grace period?
5. What is the difference between a revocable and irrevocable beneficiary?
6. What happens to an unpaid policy loan at insured's death?
7. What is the purpose of the Automatic Premium Loan provision?
8. Which riders increase the amount of the death benefit?
9. Which rider allows the early payment of a portion of the death benefit to the insured?
10. What are the 3 nonforfeiture options in life insurance policies?
11. Which nonforfeiture option is automatically selected if the policyowner has not made a selection?
12. Which dividend option increases the death benefit?
13. What settlement options are available in life insurance policies?

EXAM BREAKDOWN

See where to spend your valuable study time! Check out the Exam Breakdown at the beginning for chapter percentages.

TERMS TO KNOW

Activities of daily living (ADLs) — a person's essential activities that include bathing, dressing, eating, transferring, toileting, continence
Assignment — transfer of rights of policy ownership
Consideration — something of value that each party gives to the other (binding force in any contract)
Indemnity — a principle of reimbursement on which insurance is based; in the event of loss, an insurer reimburses the insureds or beneficiaries for the loss
Lump sum — payment of the entire benefit in one sum
Minor — a person under legal age
NAIC — National Association of Insurance Commissioners, an organization composed of insurance Commissioners from all states and jurisdictions formed to resolve insurance regulatory issues
Principal — the face value of the policy; the original amount invested before the earnings

A. Policy Provisions

While there is no "standard" policy form in life insurance, the standard policy provisions adopted by the National Association of Insurance Commissioners (NAIC) create uniformity among life insurance policies.

The following are commonly known as **standard** life insurance provisions:

- Entire contract
- Insuring clause
- Consideration
- Payment of premiums
- Grace period
- Reinstatement
- Incontestability
- Misstatement of age and/or gender

1. Entire Contract

The *entire contract* provision stipulates that the **policy and a copy of the application**, along with any riders or amendments, constitute the entire contract. No statements made before the contract was written can be used to alter the contract. Neither the insurer nor the insured may change policy provisions once the policy is in effect without both parties agreeing to it and the change being affixed to the contract.

2. Insuring Agreement

The insuring clause (or insuring agreement) sets forth the basic agreement between the insurer and the insured. It states the insurer's promise to pay the death benefit upon the insured's death. The insuring clause usually is located on the policy face page, and also defines who the parties to the contract are, the premium to be paid, how long coverage is in force, and the amount of the death benefit.

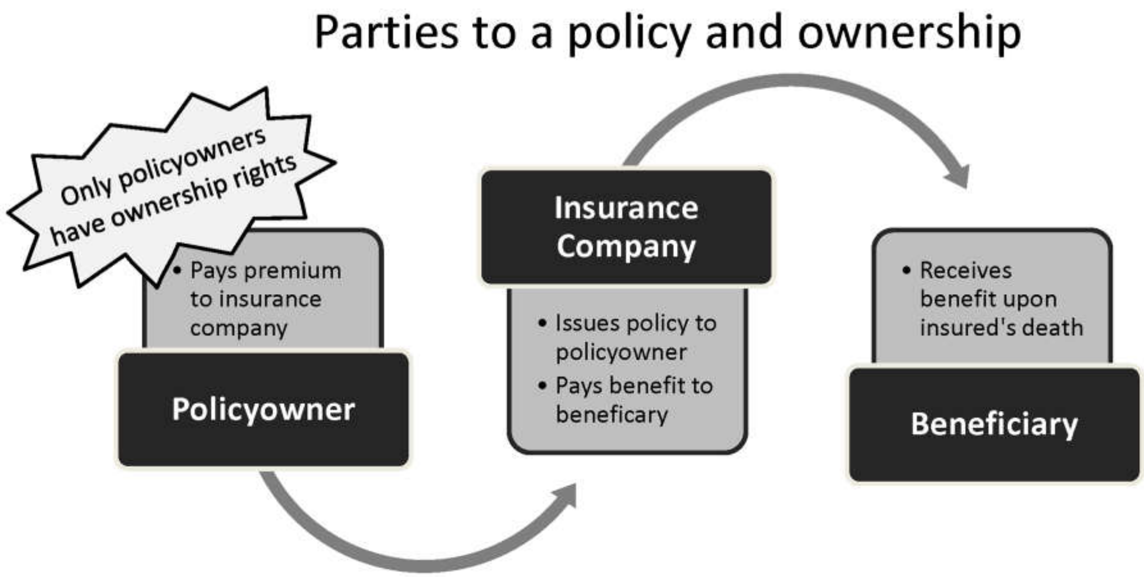
3. FREE LOOK

This provision allows the policyowner **10 days** from receipt to look over the policy and if dissatisfied for any reason, return it for a full refund of premium. **The free-look period starts when the policyowner receives the policy (policy delivery)**, not when the insurer issues the policy. Certain life insurance transactions, such as replacement, may require a longer free-look period.

4. CONSIDERATION

Both parties to a contract must provide some value, or **consideration**, in order for the contract to be valid. The consideration provision states that the consideration (value) offered by the insured is the premium and statements made in the application. The consideration given by the insurer is the promise to pay in accordance with the terms of the contract. The consideration clause is not always a separate provision, but is often included in the entire contract provision. A separate provision concerning the payment of policy premiums is usually also found in the policy.

5. OWNER'S RIGHT



The parties to the insurance contract are the insurer, the policyowner, the insured, and the beneficiary. The policyowner and the insured may be the same person or different persons. Regardless, only the policyowner has the ownership rights under the policy, and not the insured or the beneficiary. Among the ownership rights are naming and changing the beneficiary, receiving the policy's living benefits, selecting a benefit payment options, and assigning the policy.

The *policyowner* has the responsibility of paying the policy premiums, and is also the person who must have an insurable interest in the insured at the time of application for the insurance. When the owner and the insured are not the same person, the insurance arrangement is referred to as the third-party ownership.

6. ASSIGNMENT

The policyowner of a life insurance policy has the right to transfer partial or complete ownership of the policy to another person without the consent of the insurer. However, the owner must advise the insurer in writing of the assignment. Transfer of the life insurance policy **does not change the insured or amount of coverage**; it only changes who has the policy ownership rights.

The assignment provision specifies the policyowner's right to assign (transfer rights of ownership) the policy. The policyowner must advise the insurer in writing of the assignment. There are 2 types of policy assignment:

- **Absolute Assignment** — involves transferring **all rights** of ownership to another person or entity. This is a permanent and total transfer of all the policy rights. The new policyowner does not need to have an insurable interest in the insured.
- **Collateral Assignment** — involves a transfer of **partial rights** to another person. It is usually done in order to secure a loan or some other transaction. A collateral assignment is a partial and temporary assignment of some of the policy rights. Once the debt or loan is repaid, the assigned rights are returned to the policyowner.

7. Payment of Premium

The policy stipulates when the premiums are due, how often they are to be paid (monthly, quarterly, semiannually, annually, etc.) and to whom. If the insured dies during a period of time for which the premium has been paid, the insurer must refund any unearned premium along with the policy proceeds. The payment of premium provision also stipulates that premiums must be paid in advance.

Most life insurance policies have a **level premium**, which means that the premium remains the same throughout the duration of the contract. **Flexible premium** policies allow the policyowner to increase or decrease the premium during the policy period.

8. Grace Period

The grace period is the period of time after the premium due date that the policyowner has to pay the premium before the policy lapses (usually 30 or 31 days). The purpose of the grace period is to protect the policyholder against an unintentional lapse of the policy. If the insured dies during this period, the death benefit is payable; however, any unpaid premium will be deducted from the death benefit.

9. Reinstatement

The reinstatement provision allows a lapsed policy to be put back in force. The maximum time limit for reinstatement is usually **3 years** after the policy has lapsed. If the policyowner elects to reinstate the policy, he/she will have to provide evidence of insurability. The policyowner is required to pay all back premiums plus interest, and may be required to repay any outstanding loans and interest. The advantage to reinstating a lapsed policy as opposed to purchasing a new one is that the policy will be restored to its original status, and retain all the values that were established at the insured's issue age.

Note that a policy that has been surrendered cannot be reinstated.

10. Incontestability

The incontestability clause prevents an insurer from denying a claim due to statements in the application after the policy has been in force for **2 years**, even if there has been a material misstatement of facts or concealment of a material fact. During the first 2 years of the policy, an insurer may contest a claim if the insurer feels that inaccurate or misleading information was provided in the application. The incontestability period does not apply in the event of nonpayment of premiums; it also does not usually apply to statements relating to age, sex or identity.

11. Misstatement of Age and Gender

Because the age and gender of an insured are important to the premium that will be charged for a life insurance policy, a provision which allows the insurer to adjust the policy at any time due to a misstatement of age or gender is included in the policy. If the applicant has misstated his or her age or gender on the application, in the event of a claim, the insurer is allowed to adjust the benefits to an amount that the premium at the correct age or gender would have purchased. The proceeds calculations should be based on the insurer's rate at the date of policy issue.

12. Exclusions

Exclusions are the types of risks the policy will not cover. Certain exclusions are standard for all policies, while others are attached to the policy as an exclusion rider. The most common exclusions found in life insurance policies are aviation, hazardous occupation, and war and military service.

Aviation: Most life insurance will cover an insured as a fare-paying passenger or a pilot on a regularly scheduled airline, but will exclude coverage for noncommercial pilots, or require an additional premium for the coverage.

Hazardous Occupations or Hobbies: If the insured is engaged in a hazardous occupation or participates in hazardous hobbies (such as skydiving or auto racing), death that results from the hazardous occupation or hobby may be excluded from coverage. The underwriter also has the option of charging a higher premium for insuring these risks.

War or Military Service: Most life insurance policies issued today do not exclude military service. However, there are actually two different types of exclusions that may be used to limit the death benefit if the insured dies as a result of war, or while serving in the military. The **status clause** excludes all causes of death while the insured is on active duty in the military. The **results clause** only excludes the death benefit if the insured is killed as a result of an act of war (declared or undeclared).

Suicide

The **suicide** provision in life insurance policies protects the insurers from individuals who purchase life insurance with the intention of committing suicide. Insurance policies usually stipulate a period of time during which the death benefit will not be paid if the insured commits suicide. The insureds beneficiary will only be entitled to a refund of premiums. However, if a suicide is committed after the period of time stipulated in the suicide clause, the entire death benefit will be paid.

COMMON LIFE POLICY PROVISIONS	CHARACTERISTICS
Entire Contract	Policy (with riders and amendments) + copy of the application
Payment of Premium	Paid in advance: when, how often, and to whom
Grace Period	30/31 days after premium is due to prevent policy lapsing
Reinstatement	3 years to reinstate a lapsed policy with proof of insurability
Incontestability	2 years for the company to contest misstatements on the application
Misstatement of Age or Gender	Death benefit is adjusted to the amount according to the right age or gender at policy issue
Ownership	Policyowner has ownership rights
Assignment	Absolute (all rights) or collateral (partial rights)
Right to Examine/Free Look	Usually 10 days to return the policy for a full refund of premium
Exclusions	Aviation, hazardous occupation/hobbies, and war or military service; suicide excluded for a specific period of time

B. BENEFICIARIES

The *beneficiary* is the person or interest to which the policy proceeds will be paid upon the death of the insured. The beneficiary may be a person, class of persons (sometimes used with children of the insured), the insured's estate, or an institution or other entity such as a foundation, charity, corporation or trustee of a trust. Trusts are commonly used in conjunction with beneficiary designations to manage life insurance proceeds for a minor or for estate tax purposes (although naming a trust as beneficiary does not avoid estate taxes).

The beneficiary does not have to have an insurable interest in the insured. In addition, the policyowner does not have to name a beneficiary in order for the policy to be valid.

Benefits designated to a **minor** will either be paid to the minor's guardian, or paid to the trustee of the minor if the trust is the named beneficiary, or paid as directed by a court. The guardian and trustee can be the same person. It is generally accepted not to be a good practice to have life insurance benefits payable to a minor.

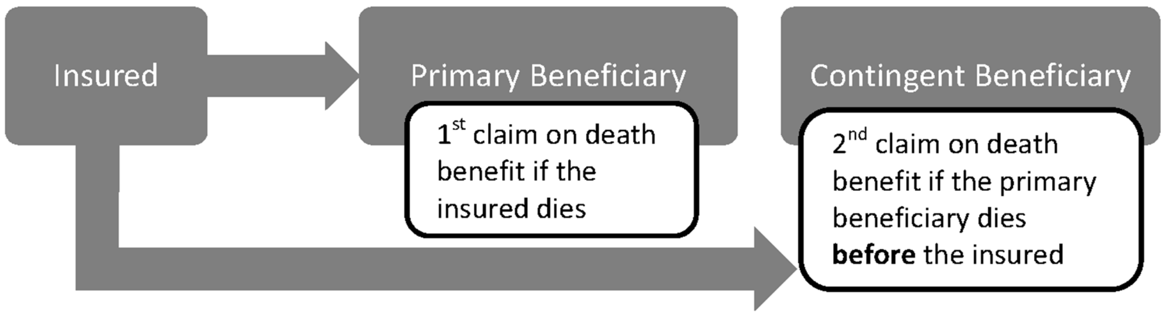
1. SUCCESSION - PRIMARY AND CONTINGENT

The beneficiary designation can provide for three levels of priority or choice. In the event that the first beneficiary predeceases the insured, the second (or sometimes third) level in the succession of beneficiaries will be entitled to the death proceeds. Each level in the succession of beneficiaries is only eligible for the death benefit if the beneficiary(s) in the level(s) above them has died before the insured.

The **primary beneficiary** has first claim to the policy proceeds following the death of the insured. The policyowner may name more than one primary beneficiary, as well as how the proceeds are to be divided.

The **contingent beneficiary** (also referred to as *secondary* or *tertiary* beneficiary) has second claim in the event that the primary beneficiary dies before the insured. Contingent beneficiaries do not receive anything if the primary beneficiary is still living at the time of the insured's death.

If none of the beneficiaries is alive at the time of the insured's death, or if no beneficiary has been named, the insured's **estate** will automatically receive the proceeds of a life insurance policy. The death benefit of the policy may be included in the insured's taxable estate if this occurs.



2. Revocable and Irrevocable

Beneficiary designations may be either revocable or irrevocable. The policyowner, without the consent or knowledge of the beneficiary, may change a **revocable** designation at any time. An **irrevocable** designation may not be changed *without the written consent of the beneficiary*. Irrevocable beneficiaries have a vested interest in the policy; therefore, the policyowner may not exercise certain rights *without the consent of the beneficiary*. In addition to being unable to change the beneficiary designation, the policyowner cannot borrow against the policy's cash value (as this would decrease the policy face value until repaid) or assign the policy to another person *without the beneficiary's agreement*.

3. Common Disaster

If the insured and the primary beneficiary die at approximately the same time from a common accident with no clear evidence as to who died first, a problem may arise in identifying which party is eligible for the death benefit. The **Common Disaster Clause**, which is provided under the Uniform Simultaneous Death Law, has been adopted by most states to address this problem, in order to protect the policyowner's original intent, as well as to protect the contingent beneficiary.

Under the **Uniform Simultaneous Death Law**, it will be assumed that the primary beneficiary died first in a common disaster. This provides that the proceeds will be paid to either the contingent beneficiary or to the insured's estate, if no contingent beneficiary is designated. The intent is to fulfill the wishes of the policyowner. Most insurers specify a certain period of time, usually 14 to 30 days, in which death must occur in order for this provision to apply. As long as the beneficiary dies within this specified period of time following the death of the insured, it will still be interpreted that the beneficiary died first.

C. Policy Loans

The **policy loan** option is found only in policies that contain cash value. The policyowner is entitled to borrow an amount equal to the available cash value. Any outstanding loans, and accrued interest, will be deducted from the policy proceeds upon the insured's death. The policy will not lapse with an outstanding policy loan unless the amount of the loan and accrued interest exceeds the available cash value. However, the insurer must provide **30 days' written notice** to the policyowner that the policy is going to lapse. Insurance companies may defer a policy loan request for **up to 6 months**, unless the reason for the loan is to pay the policy premium. Policy loans are not subject to income taxation.

1. Automatic Premium Loans

The automatic premium loan provision is not required, but is commonly added to contracts with a cash value at no additional charge. This is a special type of **loan that prevents the unintentional lapse of a policy** due to nonpayment of the premium. *For example*, a loan against the policy cash value for the amount of premium due is automatically generated by the insurer when the policyowner has not paid the premium by the end of the premium-paying grace period. It is a loan for which the insurer will charge interest. If the loan and interest are not repaid and the insured dies, then it will be subtracted from the death benefit. While the insurer may defer requests for other loans for a period of up to **6 months**, loan requests for payment of due premiums must be honored immediately.

Usually, the policyowner must specifically elect this provision in writing to make it effective.

D. Riders

Riders are written modifications attached to a policy that provide benefits not found in the original policy. Riders sometimes require an additional premium, but they also help tailor a policy to the specific needs of the insured, and can be classified according to their primary purpose.

1. Disability Riders

Some riders provide benefits in the event of the insured's disability, while other riders provide for partial payment of the death benefit prior to the insured's death, called accelerated or living benefits riders.

Waiver of Premium

The **waiver of premium** rider waives the premium for the policy if the insured becomes totally disabled. Coverage remains in force until the insured is able to return to work. If the insured is never able to return to work, the premiums will continue to be waived by the insurance company. Most insurers impose a 6-month **waiting period** from the time of disability until the first premium is waived. If the insured is still disabled after this waiting period, the insurer will refund the premium paid by the insured from the start of the disability. This rider usually expires when the insured reaches age 65.

In order for the insured to qualify for this benefit, he or she must meet the policy's definition of **total disability**. Although this definition will differ from one policy to another, it is generally defined as the inability to engage in any work. More specifically, total disability refers to the insured's inability to perform the duties of his/her own occupation for the first 2 years; then any gainful employment for which the insured is reasonably suited by education, training and experience. No benefits are payable for partial disability.

Waiver of Monthly Deduction

The **waiver of monthly deductions** rider pays all monthly deductions while the insured is disabled, after a 6-month waiting period. This rider only pays the monthly deductions, and not the full premium necessary to accumulate cash values. The length of time this rider will pay monthly deductions will vary based on the age at which the insured becomes disabled. This rider is usually found in Universal Life and Variable Universal Life policies.

Monthly deductions include the actual cost of insurance charges, expense charges, and costs or charges for any benefits added to the policy by rider, endorsement or amendment, and which are specified in the policy to be deducted from the account value.

Payor Benefit

The **payor benefit** rider is primarily used with juvenile policies (any life insurance written on the life of a minor); otherwise, it functions like the waiver of premium rider. If the payor (usually a parent or guardian) becomes disabled for at least 6 months or dies, the insurer will waive the premiums until the minor reaches a certain age, such as 21. This rider is also used when the owner and the insured are two different individuals.

2. Riders Covering Additional Insured

There are riders that allow the policyowner to add additional insureds under the original policy, such as children's term or family term. There is also a nonfamily term rider that allows the policyowner to change the insured under the policy.

Spouse/Other-insured Term

The **other insured rider** provides coverage for one or more family members other than the insured. The rider is usually level term insurance, attached to the base policy covering the insured. This is also known as a family rider. If the rider covers just the spouse of the insured, it can be specified as a **spouse term rider**, and allows the spouse to be added to coverage for a limited period of time and for a specified amount (it usually expires when the spouse reaches age 65).

Children's Term

The **children's term rider** allows children of the insured (natural, adopted or stepchildren) to be added to coverage for a limited period of time for a specified amount. This coverage is also term insurance and usually expires when the minor reaches a certain age (18 or 21). Most riders provide the minor with the option of converting to a permanent policy without evidence of insurability.

Children's term riders provide temporary life insurance coverage on all children of the family for one premium. The premium does not change on the inclusion of additional children; it is based on an average number of children.

The **family term rider** incorporates the spouse term rider along with the children's term rider in a single rider. When added to a whole life policy, the family term rider provides level term life insurance benefits covering the spouse and all of the children in the family.

Family Term = Spouse Term + Children's Term

Nonfamily Insureds

Other riders are also available to insure somebody who is not a member of the insured's family — **nonfamily insureds**. The *substitute insured* or *change of insured* rider does not permit an additional insured, but instead allows for the change of insureds, subject to insurability. It is most commonly used with Key Person insurance when the key person or employee retires or terminates employment.

The rider permits the policyowner, owner or employer, to change the insured to another key employee, subject to insurability.

3. Riders Affecting the Death Benefit Amount

Some riders affect the amount of the death benefit paid out to the beneficiary, and either increase it through multiple indemnity or refunds of premiums, or decrease it if a portion of the death benefit was paid out to the insured while still living.

Accidental Death and/or Accidental Death and Dismemberment

The **accidental death rider** pays some multiple of the face amount if death is the result of an accident as defined in the policy. Death must usually occur within 90 days of such an accident. The benefit is normally two times (**double indemnity**) the face amount. Some policies pay triple the face amount (**triple indemnity**) for accidental death.

Each policy specifies what will be considered *accidental death*. Accidental death does not include death that results from any health problem or disability. In addition, deaths that result from self-inflicted injuries, war, or hazardous hobbies or avocations are usually not covered. They would be covered under the base policy unless specifically excluded.

This rider often expires at the insured's age 65. No additional cash value is accumulated as a result of this rider. The accidental death benefits apply only to the policy's base face amount, and not to any additional benefits that may be purchased from policy dividends.

The **accidental death and dismemberment rider (AD&D)** pays the **principal** (face amount) for accidental death, and pays a percentage of that amount, or a **capital sum**, for accidental dismemberment. The accidental death portion is the same as that already discussed with the accidental death rider. The dismemberment portion of the rider will usually determine the amount of the benefit according to the severity of the injury. The full principal amount will usually be paid for loss of two hands, two arms, two legs or the loss of vision in both eyes. A capital amount is usually limited to half the face value and is payable in the event of the loss of one hand, arm, leg, or eye. The dismemberment can be defined differently by insurance companies, from the actual severance of the limb to the loss of use.

Guaranteed Insurability

The **guaranteed insurability** rider allows the insured to purchase additional coverage at specified future dates (usually every 3 years) or events (such as marriage or birth of a child), without evidence of insurability, for an additional premium. When this option is exercised, the insured purchases the additional coverage at his or her attained age. This rider usually expires at the insured's age 40.

The guaranteed insurability rider is not modified or defeated by the existence of other riders.

<u>*Example:*</u>

Alan's life insurance policy contains both guaranteed insurability and waiver of premium rider. Three years after the policy was issued, Alan was totally and permanently disabled. Not only are Alan's life insurance premiums waived, but at the specified times or events stated in the policy, Alan may purchase additional amount of insurance with the premiums on those increases also waived.

RETURN OF PREMIUM

The **return of premium** rider is implemented by using increasing term insurance. When added to a whole life policy, it provides that at death prior to a given age, not only is the original face amount payable, but an amount equal to all premiums previously paid is also payable to the beneficiary. The return of premium rider usually expires at a specified age such as age 60.

TERM RIDERS

Term riders allow for an additional amount of temporary insurance to be provided on the insured, without the need to issue another policy. They are usually attached to a whole life policy to provide greater protection at a reduced cost.

ACCELERATED (LIVING) BENEFIT RIDER AND LONG-TERM CARE RIDERS

Accelerated death benefits allow the **early payment** of a portion of the death benefit if the insured has any of the following conditions:

- A terminal illness;
- A medical condition that requires an extraordinary medical intervention (such as an organ transplant) for the insured to survive;
- A medical condition that without extensive treatment drastically limits the insured's life time;
- Inability to perform activities of daily living (ADLs);
- Permanent institutionalization or confinement to a long-term care facility;
- Any other conditions approved by the Department of Insurance.

The maximum benefit is typically a percentage of the face amount of insurance, usually 50%, but it is legal for the insurer to pay up to 100% of the death benefits before the insured dies. There may also be a dollar limit, such as $100,000. The face amount of insurance is reduced after the payments. The accelerated death benefit payout will not necessarily result in a reduction of the premium; however, premium may be waived.

The **Living Needs Rider** provides for the payment of part of the policy death benefit if the insured is diagnosed with a terminal illness that will result in death within 2 years. The purpose of this rider is to provide the insured with the necessary funds to take care of necessary medical and nursing home expenses that incur as a result of the terminal illness. Many insurance companies do not charge for this rider since it is simply an advance payment of the death benefit. The remainder of the policy proceeds are payable to the beneficiary at the time of the insured's death.

Long-Term Care (LTC) coverage, which is often purchased as a separate policy, can also be marketed as a rider to a life insurance policy. These riders provide for the payment of part of the death benefit (called accelerated benefits) in order to take care of the insured's health care expenses, which are incurred in a nursing or convalescent home. As with the living needs rider, payment of LTC benefits will reduce the amount payable to the beneficiary upon the insured's death.

EFFECT ON DEATH BENEFIT

If an insured withdraws a portion of the face amount by the use of the accelerated benefits rider, the benefit payable at death will be reduced by that amount, plus the amount of earnings lost by the insurance company in interest income.

Payable Death Benefit = Face Amount - Amount withdrawn - Earnings lost by insurer in interest

Example:

The policy's face amount is $100,000; however, due to a terminal illness, the insured had to withdraw $30,000 from the policy 3 years before his death. Since this amount was withdrawn, the insurance company lost $300 worth of interest. Upon the insured's death, the beneficiary received $69,700 in death benefit:

$100,000 (face amount) - $30,000 (accelerated benefit) - $300 (lost interest) = $69,700

Here's a breakdown of the most common riders available in life insurance policies.

TYPE OF RIDER	AVAILABLE RIDERS
Disability Riders	• Waiver of Premium • Waiver of Monthly Deduction • Payor Benefit • Disability Income • Accelerated (Living) Benefit
Riders Covering Additional Insured	• Spouse • Children • Family • Nonfamily
Riders Affecting Death Benefit	• Accelerated Death Benefit • Accidental Death or AD&D • Guaranteed Insurability • Return of Premium • Term Riders

E. OPTIONS

Policyowners have decisions to make about how the cash value in the policy should be protected, how the return of excess premium (dividends) should be invested, and how benefit payments will be made. The different choices available to them are categorized as Nonforfeiture Options, Dividend Options, and Settlement Options.

1. NONFORFEITURE OPTIONS

Because permanent life insurance policies have cash values, certain guarantees are built into the policy that **cannot be forfeited** by the policyowner. These guarantees (known as nonforfeiture values) are required by state law to be included in the policy. A table showing the nonforfeiture values for a minimum period of 20 years must be included in the policy. The policyowner chooses one of the following nonforfeiture options: cash surrender value, reduced paid-up insurance, or extended term.

Reduced Paid-up Insurance

Under this option, the policy cash value is used by the insurer as a single premium to purchase a completely paid-up permanent policy that has a **reduced face amount** from that of the former policy. The new reduced policy builds its own cash value and will remain in force until death or maturity.

Extended Term

Under the extended-term option, the insurer uses the policy cash value to convert to term insurance for the **same face amount** as the former permanent policy. The duration of the new term coverage lasts for as long a period as the amount of cash value will purchase. If the policyowner has neglected to select one of these nonforfeiture options, the insurer will **automatically** implement the extended-term option in the event of termination of the original policy.

Cash

The policyowner simply surrenders the policy for the current cash value at a time when coverage is no longer needed or affordable. Upon receipt of the cash surrender value, if the cash value exceeds premiums paid, the excess is taxable as ordinary income. Once this option is selected, the insured is no longer covered. A policy that has been surrendered for its cash value cannot be reinstated. A *surrender charge* is a fee charged to the insured when a life policy or annuity is surrendered for its cash value.

<u>Example:</u> *(review a sample Table of Guaranteed Values on the next page)*

If the insured chooses to exercise the reduced paid-up option at the end of 15 years, the cash value of $8,100 can be used as a single premium to purchase paid-up insurance of the same type as the original policy. The insured doesn't have to pay any more premiums, while still retaining some amount of life insurance (in this example, $21,750).

The extended-term option indicates the option to use the policy's cash value to purchase in a single premium a term insurance policy in an amount equal to the original policy's face value (in this case, term insurance with $50,000 face amount). The insurance company determines that for this particular insured, $8,100 of cash value is worth 18 years and 8 days of $50,000 of protection.

Table of Guaranteed Values
$50,000 Whole Life Nonforfeiture Table (20 years)

End of Policy Year	Cash or Loan Value	Reduced Paid-up	Extended Term	
			Years	Days
1	$0	$0	0	60
2	$50	$250	0	122
3	$400	$1,600	2	147
4	$950	$3,600	5	27
5	$1,550	$5,650	7	183
6	$2,150	$7,600	9	185
7	$2,750	$9,400	11	52
8	$3,350	$11,100	12	186
9	$4,000	$12,850	13	315
10	$4,650	$14,500	15	6
11	$5,300	$16,050	15	333
12	$6,000	$17,600	16	249
13	$6,700	$19,100	17	95
14	$7,400	$20,450	17	255
15	**$8,100**	**$21,750**	**18**	**8**
16	$8,650	$23,050	18	116
17	$9,850	$24,440	18	208
18	$10,400	$25,550	18	227
19	$11,200	$26,750	18	231
20	$12,000	$27,850	18	200
		Lasts the longest	*Provides the most*	

2. DIVIDEND OPTIONS

Dividends are paid only on participating policies. When the policyowner purchases a policy from a participating insurer, he or she actually pays a "grossed-up" premium. The higher premium is charged as a safety margin in the event the insurer's losses are higher than anticipated. If this extra amount is not needed by the insurer to pay death claims and expenses, or if actual mortality experience improves or interest earned by the company exceeds the assumptions, a dividend will be returned to the policyowner. In other words, dividends are a return of excess premiums, and for that reason they are **not taxable** to the policyowner. Insurance companies **cannot guarantee** dividends.

The first dividend could be paid as early as the 1st policy anniversary, but must occur no later than the end of the 3rd policy year. From then on dividends are usually paid on an annual basis. Policyowners have the option of taking their dividends in one of several different ways.

CASH

The insurer simply sends the policyowner a check for the amount of the dividend as it is declared, usually annually.

Reduction of Premium

The insurer uses the dividend to reduce the next year's premium. *For example*, if the policyowner usually pays an annual premium of $1,000 and the insurer declares a $100 dividend, the policyowner would only pay a $900 premium that year.

Accumulation at Interest

The insurance company keeps the dividend in an account where it accumulates interest. The policyowner is allowed to withdraw the dividends at any time. The amount of interest is specified in the policy and compounds annually. Although the dividends themselves are not taxable, the **interest on the dividends is taxable** to the policyowner when credited to the policy, whether or not the policyowner receives the interest.

Paid-up Additions

The dividends are used to purchase a single premium policy in addition to the face amount of the permanent policy. No new separate policies are issued; however, each of these small single premium payments will **increase the death benefit** of the original policy by whatever amount the dividend will buy. In addition, each of these paid-up policies will accumulate cash value and pay dividends. The amount of additional coverage that can be purchased with the dividend is based on the insured's attained age at the time the dividend is declared.

Paid-up Option

Usually, the insurer first accumulates the dividends at interest and then uses the accumulated dividends, plus interest, and the policy cash value to pay the policy up early. In other words, if the insured had a continuous premium whole life policy (in which premiums are paid to age 100), using the paid-up option the policyowner is able to pay up the policy early.

One-year Term Option

The insurance company uses the dividend to purchase additional insurance in the form of **one-year term insurance** that increases the overall policy death benefit. The policyowner's choice is to either use the dividend as a single premium on as much one-year term insurance as it will buy, or to purchase term insurance equal to the policy's cash value for as long as it will last. If the insured dies during the one-year term, the beneficiary receives both the death benefit of the original policy and the death benefit of the one-year term insurance.

3. Settlement Options

Settlement options are the methods used to pay the death benefits to a beneficiary upon the insured's death, or to pay the endowment benefit if the insured lives to the endowment date. The policyowner may select a settlement option at the time of policy application, and may also change that option at any time during the life of the insured. Once selected by the policyowner, the settlement option cannot be changed by the beneficiary. If the policyowner does not select a settlement option, the beneficiary will be allowed to choose one at the time of the insured's death.

Cash Payment

Upon the death of the insured, or at the point of endowment, the contract is designed to pay the proceeds in cash, called a **lump sum**, unless the recipient chooses a different mode of settlement. As a rule, payments of the principal face amount after the insured's death are not taxable as income.

Life Income

The **life-income option**, also known as straight life, provides the recipient with an income that he or she cannot outlive. Installment payments are guaranteed for as long as the recipient lives, irrespective of the date of death. The amount of each installment paid is based on the **recipient's** life expectancy and the amount of principal. If the beneficiary lives for a very long time, payments may exceed the total principal. However, if the beneficiary dies shortly after he or she begins receiving installments, the balance of the principal is forfeited to the insurer. Because there is a chance that the beneficiary may not live long enough to receive all the life insurance proceeds, insurers make options available which provide at least a partial guarantee that some or all of the proceeds will be paid out. With each of the guarantees, the size of the installment is decreased.

Single Life

The **single life option** can provide a single beneficiary income for the rest of his/her life. Upon the death of the beneficiary, the payments stop.

Joint and Survivor

The **life income joint and survivor** option guarantees an income for two or more recipients for as long as they live. Most contracts provide that the surviving recipient will receive a reduced payment after the first recipient dies.

Most commonly, the reduced option is written as "joint and ½ survivor" or "joint and ⅔ survivor," in which the surviving beneficiary receives ½ or ⅔ of what was received when both beneficiaries were alive. This option is commonly selected by the policyowner who wants to protect two beneficiaries, such as elderly parents. Unless a period certain option is also chosen, as with the life income option, there is no guarantee that all the life insurance proceeds will be paid out if all beneficiaries die shortly after the installments begin. This option guarantees, however, an income for the lives of all beneficiaries.

Life Refund

The **life refund income** option comes in either a *cash refund* form or an *installment refund* form. Both options guarantee that the total annuity fund will be paid out to the annuitant or to the beneficiary. The difference between the two options is that under the **cash refund option**, if the annuitant dies before the annuity fund is depleted, a lump-sum settlement of the remainder would be made to the beneficiary, while under the **installment refund option,** the beneficiary would receive the remaining funds in the form of continued annuity payments.

Life with Period Certain

Under **life income with period certain option**, the recipient is provided with the "best of both worlds" in terms of a lifetime income and a guaranteed installment period. Not only are the payments guaranteed for the lifetime of the recipient, but there is also a specified period that is guaranteed. *For example*, a life income with 10 years certain option would provide the recipient with an income for as long as he or she lives. If the recipient dies shortly after starting to receive the payments, the payments will be continued to a beneficiary for the remainder of the 10-year period. As already stated, the installments for the life income with period certain option will be smaller than the life income only option.

Interest Only

With the **interest-only option**, the insurance company retains the policy proceeds and pays interest on the proceeds to the recipient (beneficiary) at regular intervals (monthly, quarterly, semiannually, or annually). The insurer usually guarantees a certain rate of interest and will often pay interest in excess of the guaranteed rate. The interest option is considered to be a temporary option since the proceeds are retained by the insurer until some later point when the proceeds are paid out in a lump sum or paid under one of the other settlement options. When the beneficiary is allowed to select a settlement option, the interest option is sometimes used as a temporary option if the beneficiary needs some time to decide which settlement option to select. *For example,* the policyowner may specify that interest only will be paid annually to the surviving spouse, with the principal to be paid to their children when they reach a certain age or at the death of the surviving spouse.

Fixed-Period Installments

Under the **fixed-period installments option** (also called **period certain**), a specified period of years is selected, and equal installments are paid to the recipient. The payments will continue for the specified period even if the recipient dies before the end of that period. In the event of the recipient's death, the payments would continue to a beneficiary. The size of each installment is determined by the amount of principal, guaranteed interest, and the length of period selected. The longer the period selected, the smaller each installment will be. This option does not guarantee income for the life of the beneficiary; however, it does guarantee that the entire principal will be distributed.

Fixed-Amount Installments

The **fixed-amount installments option** pays a fixed, specified amount in installments until the proceeds (principal and interest) are exhausted. The recipient selects a specified fixed dollar amount to be paid until the proceeds are gone. If the beneficiary dies before the proceeds are exhausted, installments will continue to be paid to a contingent beneficiary until all proceeds have been paid out. With this option, the size of each installment will determine how long benefits will be received. The larger the installment, the shorter the income period will be. As with the fixed-period option, this option does not guarantee payments for the life of the beneficiary, but does guarantee that all proceeds will be paid out.

OPTION TYPE	AVAILABLE OPTIONS
Nonforfeiture Options	• Reduced Paid-up • Extended Term *(automatic)* • Cash
Dividend Options	• Cash • Reduction of Premium • Accumulation at Interest • Paid-up Additions *(automatic)* • Paid-up Insurance • One-year Term
Settlement Options	• Cash *(automatic)* • Life Income • Interest Only • Fixed Period • Fixed Amount

F. Chapter Recap

Make sure you review the following key terms before moving on to the next chapter:

Life Policy Provisions	Assignment Consideration Entire contract Free look Grace period Incontestability Insuring clause Misstatement of age and gender Ownership Payment of premiums Reinstatement
Beneficiaries	Primary vs. Contingent Revocable vs. Irrevocable Common Disaster clause
Accessing Cash Value	Policy Loan Automatic Premium Loan
Policy Options	Nonforfeiture Dividend Settlement

In this chapter, you learned about provisions, options and riders available in life insurance policies. Remember that provisions state the rights and obligations under the contract; riders modify provisions, and options specify ways to distribute policy proceeds. Let's recap the major points of this chapter:

POLICY PROVISIONS	
Standard Provisions	• *Consideration* - parties to a contract exchange something of value • *Entire contract* - policy (with riders and amendments) and copy of the application • *Grace period* - time period after the premium is due during which the policy will not lapse • *Incontestability* - insurer cannot contest misstatements on the application after a time period • *Insuring clause* - basic agreement between the insurer and the policyowner • *Misstatement of age or gender* - death benefit is adjusted according to the correct age and gender at policy issue • *Payment of premiums* - premiums are paid in advance • *Reinstatement* - a policy can be restored within a specified period of time with proof of insurability
Other Provisions	• *Assignment* - absolute or collateral • *Exclusions* - aviation (noncommercial), hazardous occupation, war or military service, suicide within a specified time period • *Free look* - policy can be returned for a refund of premium within a specified time period • *Ownership* - policyowner's rights
Beneficiaries	• *Designations* - individuals (including minors), classes, estates • *Succession* - the levels of priority. Each level in the succession is only eligible if the beneficiary in the level above has died: - Primary - first claim to the policy proceeds - Contingent (secondary, tertiary) - next claim after primary • *Policyowner's right to change a beneficiary:* - Revocable - can be changed at any time - Irrevocable - can only be changed with the beneficiary's consent • *Common disaster clause* - protects the rights of contingent beneficiaries; if the insured and the primary beneficiary died at approximately the same time, it is assumed that the primary beneficiary died first
Policy Loans, Withdrawals and Partial Surrenders	• *Cash loans available* - policy's cash value minus any unpaid loans and interest • *Automatic premium loans* - prevent unintentional policy lapse due to nonpayment of premium
RIDERS	
Disability	• *Waiver of premium* - waives the premium if the insured becomes totally disabled; 6-month waiting period before benefits begin • *Waiver of monthly deductions* - waives the cost of insurance in the event of the insured's disability • *Payor benefit* - functions like a waiver of premium rider; used for juvenile policies

Accelerated Benefit	• Early payment if insured is diagnosed with a specified catastrophic illness • A portion of the death benefit • Death benefit is reduced by the amount paid plus earnings lost by the insurer
Additional Insured	• *Spouse/other insured* - term rider (limited time, limited coverage); usually expires when spouse turns age 65 • *Children's term* - covers all children of the insured (limited time, limited coverage); can be converted to a permanent policy • *Nonfamily insured* - used by businesses (e.g. key person insurance)
Riders that affect the Death Benefit	• *Accidental death* - pays double or triple indemnity if accidental death occurs as defined in the policy; death must occur within 90 days of accident • *Guaranteed insurability* - allows for purchase of additional insurance at specified times without evidence of insurability, at the insured's attained age • *Return of premium* - increasing term is added to a whole life policy that provides that if death occurs prior to a given age, not only is the death benefit payable to the beneficiary, but all premiums paid as well
OPTIONS	
Nonforfeiture	• *Reduced paid-up insur*ance - uses cash value as a single premium to purchase a permanent policy with a reduced face amount • *Extended term* - automatic option; uses cash value to convert to term insurance • *Cash surrender value* - after that, no more insurance
Dividend	• *Cash* - insurer sends a check to the insured • *Reduction of premium* - dividend is applied to the next year's premium • *Accumulation at interest* - insurer keeps the dividend in an account where it accumulates interest • *Paid-up additi*on - dividend is used to increase the face amount • *Paid-up insurance* - dividend is used to pay up a policy early • *One-year term* - dividend is used to buy additional insurance
Settlement	• *Cash* - lump-sum payment; usually not taxable • *Life income* - provides an income the beneficiary cannot outlive; no guarantee that the entire principal will be paid out (if the beneficiary dies too soon); available as single life or as joint and survivor • *Interest only* - insurer retains the principal and only pays out interest • *Fixed period* - payments for a specified time period until all the proceeds are paid out • *Fixed amount* - payments in specified amounts until all the proceeds are paid out

G. Chapter Quiz - Life Policy Provisions, Riders, and Options

1. Which provision of a life insurance policy states that the application is part of the contract?

A. Insuring clause
B. Ownership
C. Entire contract
D. Assignment

2. A life insurance policy clause that prevents an insurance company from denying payment of a death claim after a specified period of time is known as the

A. Misstatement of age clause.
B. Incontestability clause.
C. Reinstatement clause.
D. Legal action.

3. When a death claim is submitted, the insurer discovered that the insured understated her age on the application for a life policy. What action will the insurer take?

A. Deny the claim based on material misrepresentation on the application
B. Pay the face amount of the policy if the death occurred after the incontestable period
C. Pay a reduced death benefit based on the insured's actual age
D. Pay the full death benefit and sue the insured's estate for damages

4. Which of the following terms refers to the transfer of some or all of the ownership rights of a life insurance policy from one individual to another?

A. Nonforfeiture
B. Endorsement
C. Transfer of value
D. Assignment

5. Which of the following is true about the free-look period in a life insurance policy?

A. It starts when the application is signed.
B. It applies only to term life insurance policies.
C. It can be waived by an insurer.
D. It starts when the policy is delivered.

6. A spouse receives $5,000 a month until the principal and interest on her husband's life insurance policy have been paid out. Which settlement option did this beneficiary choose?

A. Life income
B. Fixed amount
C. Cash payment
D. Fixed period

7. Which of the following features allows an insurance policy to remain in force for a specific number of days beyond the premium due date?

A. Reinstatement provision
B. Nonforfeiture option
C. Grace period provision
D. Consideration clause

8. The insured usually pays $1,200 annually for her life insurance premium. This year, she has accumulated $175 in dividends, and applied that to her next premium, reducing it to $1,025. What dividend option has the insured chosen?

A. Cash option
B. Reduced paid-up
C. Reduction of premium
D. Accumulation at interest

9. All of the following are nonforfeiture options in life insurance policies EXCEPT

A. Automatic premium loans.
B. Cash surrender value.
C. Extended term.
D. Reduced paid-up insurance.

10. Which of the following statements is true of both the fixed-period and fixed-amount settlement options?

A. Both guarantee payments for the life of the beneficiary.
B. Both guarantee that the principal and interest will be fully paid out.
C. The amount of payments is based on the recipient's life expectancy.
D. The size of installments decreases after a certain period of time.

11. Which of the following is NOT a standard exclusion in life insurance policies?

A. Aviation
B. Military service
C. Hazardous occupation
D. Disability

12. Under what circumstances will the contingent beneficiary receive the death benefit?

A. If designated by the primary beneficiary
B. If contingent beneficiary is the insured's estate
C. If the primary beneficiary dies before the insured
D. If designated by the insured

13. If a life insurance policy has an irrevocable beneficiary designation,

A. The beneficiary can never be changed.
B. The beneficiary can only be changed with written permission of the beneficiary.
C. The beneficiary cannot be changed for at least 2 years.
D. The owner can always change the beneficiary at will.

14. The rider in a whole life policy that allows the company to forgo collecting the premium if the insured is disabled is called

A. Accelerated benefit.
B. Nonforfeiture.
C. Waiver of premium.
D. Guaranteed insurability.

15. All of the following are true regarding the guaranteed insurability rider EXCEPT

A. It allows the insured to purchase additional coverage without proof of insurability.
B. It is available automatically, for no extra premium.
C. The insured may purchase additional coverage at the attained age.
D. It usually expires at the insured's age 40.

Answers to the quiz may be found in Appendix A.

FLASHBACK

Test your retention of the new concepts you learned. **Flashback** to the beginning of the chapter to review the **Snapshots** before moving forward.

IV

TAXES, RETIREMENT, AND OTHER INSURANCE CONCEPTS

IV. Taxes, Retirement, and Other Insurance Concepts

INTRO

This chapter helps broaden your life insurance knowledge. It teaches you about a variety of topics, from group life insurance and plans specific for businesses, to retirement plans and social security benefits. Finally, this chapter details taxation rules that apply to life insurance premiums and proceeds.

SNAPSHOTS

1. Who owns a group life contract? What does the insured receive?
2. What are some of the group characteristics important for underwriting?
3. What are the general requirements for qualified plans?
4. Who can contribute to a traditional IRA?
5. What are the main differences between a traditional IRA and a Roth IRA?
6. What are the consequences of withdrawing money from a traditional IRA prior to age 59½?
7. Who is eligible for a Keogh (HR-10) Plan?
8. What is the maximum number of participants in a SIMPLE plan?
9. How are income payments from a 403(b) plan taxed?
10. What are some common personal uses of life insurance?
11. What is the purpose of key person insurance?
12. How are life insurance death proceeds taxed?
13. How are dividends taxed in participating policies?
14. How do accelerated benefits differ between terminally ill and chronically ill insureds?
15. When does a life insurance policy become a Modified Endowment Contract?
16. In regards to Social Security, what does the term "fully insured" mean?

EXAM BREAKDOWN

See where to spend your valuable study time! Check out the **Exam Breakdown** at the beginning for chapter percentages.

TERMS TO KNOW

Earned income — salary, wages, or commissions; but not income from investments, unemployment benefits, and similar sources of income
FIFO (First In, First Out) — principle under which it is assumed that the funds paid into the policy first will be paid out first
Gross income — a person's income before taxes or other deductions
LIFO (Last In, First Out) — principle applied to asset management in life insurance products, under which it is assumed that the funds paid into the policy last will be paid out first
Nonprofit organization — an organization that uses its surplus to fulfill its purpose instead of distributing the surplus to its owners or members
Policy endowment — maturity date
Pretax contribution — contribution made before federal and/or state taxes are deducted from earnings
Rollover — withdrawal of the money from one qualified plan and placing it into another plan
Surrender — early termination of a policy by the policyowner
Vesting — the right of a participant in a retirement plan to retain part or all of the benefits

A. Third-Party Ownership

Most insurance policies are written where the insured and owner of the policy is the same person. However, there are situations in which the contract may be owned by someone other than the insured. These types of contracts are known as **third-party ownership.** *Third-party owner* is a legal term used to identify an individual or entity that is not an insured under the contract, but that has a legally enforceable right under it. Most policies involving third-party ownership are written in business situations or for minors in which the parent owns the policy.

B. Viatical Settlements

Viatical settlements allow someone living with a life-threatening condition to sell their existing life insurance policy and use the proceeds when they are most needed, before their death.

While viatical settlements are not policy options, they are **separate contracts** in which the insured sells the death benefit to a **third party** at a discounted rate. There are several important concepts you need to understand about viaticals:

- The insureds are referred to as **viators**;
- Viatical settlement **provider** means a person, other than a viator, that enters into a viatical settlement contract;
- Viatical **producers** represent the providers;
- Viatical **brokers** represent the insureds.

Viators usually receive **a percentage** of the policy's face value from the person who purchases the policy. The new owner continues to maintain premium payments and will eventually collect the entire death benefit.

C. Life Settlements

The term **life settlement** refers to any financial transaction in which the owner of a life insurance policy sells a life insurance policy to a third party for some form of compensation, usually cash. A life settlement would require an absolute assignment of all rights to the policy from the original policyowner to the new policyowner.

Policyowners may choose to sell their policies because they feel they no longer need their coverage, or the premium costs have grown too high to justify continuation of the policy. In many cases, however, life settlement transactions are offered to senior citizens who may have a life-threatening illness and a short life expectancy. In these situations, the owner may elect to sell the policy to a life settlement provider for an amount greater than what they would receive if they surrendered the policy for cash value.

Example:

A person, age 70, owns a $1,000,000 life insurance policy. He recently sold his business for $5,000,000 and decided he no longer needed the insurance coverage. The cash value is $390,000, which the insurance company would give the policyowner if he cashed in the policy. A life settlement provider may offer him, after reviewing his medical records, $575,000 for the policy. Once ownership is transferred and the policyowner has received the funds, the life settlement company will assume premium payments until the insured dies, at which time the life settlement company will receive the proceeds of the policy - $1,000,000.

1. Definitions

Because Life Settlements are not involved in the establishment of new life insurance coverage, the Life Settlement Act defines terms that are not in conflict with the sale of the original life insurance coverage, but which accurately identify the distinctions in the Life Settlement business. Some of the more important definitions are as follows:

The term **business of life settlement** refers to **any** activity relating to the solicitation and sale of a life settlement contract to a third party who has no insurable interest in the insured.

The term **owner** refers to the owner of the life insurance policy who seeks to enter into a life settlement contract. The term does not include an insurance provider, a qualified institutional buyer, a financing entity, a special purpose entity, or a related provider trust.

Insured is the person covered under the policy that is considered for sale in a life settlement contract.

Life Expectancy is an important concept in life settlement contracts. It refers to a calculation based on the average number of months the insured is projected to live due to medical history and mortality factors (an arithmetic mean).

Life Settlement Contract establishes the terms under which the life settlement provider will pay compensation to the policyowner, in return for the assignment, transfer, sale, or release of any portion of any of the following:

- The death benefit;
- Policy ownership;
- Any beneficial interest; or
- Interest in a trust or any other entity that owns the policy.

Life Settlement Broker is a person who, for *compensation*, solicits, negotiates, or offers to negotiate a life settlement contract. Life settlement brokers represent only the policyowners, and have a fiduciary duty to the owners to act according to their instructions and in their best interest.

Life Settlement Provider is a person (other than the owner) who enters into a life settlement contract with the owner.

D. Group Life Insurance

In contrast to individual life insurance, which is written on a single life, and in which the rate and coverage is based upon the underwriting of that individual, **group life insurance** is issued to the sponsoring organization, and covers the lives of **more than one individual** member of that group. Group insurance is usually written for employee-employer groups, but other types of groups are also eligible for coverage. It is usually written as **annually renewable term** insurance. Two features that distinguish group insurance from individual insurance are

- Evidence of insurability is usually not required (unless an applicant is enrolling for coverage outside the normal enrollment period); and
- Participants (insureds) under the plan do not receive a policy because they do not own or control the policy.

Instead, each insured participant under the group plan is issued a **certificate of insurance** evidencing that they have coverage. The actual policy, or **master policy/contract**, is issued to the sponsor of the group, which is often an employer. The group sponsor is the policyholder and is the one that exercises control over the policy.

Group underwriting differs from that of individual insurance, and is based on the group characteristics and makeup. Some of the characteristics of concern to a group underwriter include the following:

- **Purpose of the group** — The group must be created for a purpose other than to obtain group insurance.
- **Size of the group** — The larger the number of people in the group, the more accurate the projections of future loss experience will be. This is based on the Law of Large Numbers of similar risks.
- **Turnover of the group** — From the underwriting perspective, a group should have a steady turnover: younger, lower-risk employees enter the group, and older, higher-risk employees leave.
- **Financial strength of the group** — Because group insurance is costly to administer, the underwriter should consider whether or not the group has the financial resources to pay the policy premiums, and whether or not it will be able to renew the coverage.

Another unique aspect of group underwriting is that the cost of the coverage is based on the average age of the group and the ratio of men to women. In addition, in order to reduce adverse selection, the insurer will require a minimum number of participants in the group, depending on whether the employer or employees pay the premium.

1. Conversion Privilege

Another characteristic of group insurance is the conversion privilege. If an employee terminates membership in the insured group, the employee has the right to convert to an individual policy ***without proving insurability*** at a standard rate, based on the individual's attained age. The group life policy can convert to any form of insurance issued by the insurer (usually whole life), *except* for term insurance. The face amount or death benefit will be equal to the group term face amount but the premium will be higher. The employee usually has a period of **31 days after terminating** from the group in order to exercise the conversion option. During this time, the employee is still covered under the original group policy.

Other rules that apply to conversion involve the death or disability of the insured, and termination of the master policy. If the insured dies during the conversion period, a death benefit equal to the maximum amount of individual insurance which would have been issued must be paid by the group policy, whether or not the application for an individual policy was completed. If the master contract is terminated, every individual who has been on the plan for at least 5 years will be allowed to convert to individual permanent insurance of the same coverage.

2. Contributory vs. Noncontributory

The employer or other group sponsor may pay all of the premiums or share premiums with the employees. When an employer pays all of the premiums, the plan is referred to as a **noncontributory plan**. Under a noncontributory plan, an insurer will require that 100% of the eligible employees be included in the plan. When the premiums for group insurance are shared between the employer and employees, the plan is referred to as a **contributory plan**. Under a contributory plan, an insurer will require that 75% of eligible employees be included in the plan.

E. Retirement Plans

1. Qualified vs. Nonqualified Plans

An employer-sponsored **qualified retirement plan** is approved by the IRS, which then gives both the employer and employee benefits such as deductible contributions and tax-deferred growth.

Qualified plans have the following characteristics:

- Designed for the exclusive benefit of the employees and their beneficiaries;
- Are formally written and communicated to the employees;
- Use a benefit or contribution formula that does not discriminate in favor of the *prohibited group* — officers, stockholders, or highly paid employees;
- Are not geared exclusively to the prohibited group;
- Are permanent;
- Are approved by the IRS; and
- Have a vesting requirement.

In contrast, nonqualified plans are not subject to the requirements regarding participation, discrimination, and vesting found in qualified plans. Nonqualified plans require no government approval and are used as a means for an employer to discriminate in favor of a valuable employee with regard to employee benefits. Nonqualified plans accept after-tax contributions.

Examples of nonqualified plans are individual annuities and deferred compensation plans for highly paid executives, split-dollar insurance arrangements, and Section 162 executive bonus plans.

The table below highlights the differences between qualified and nonqualified retirement plans.

QUALIFIED	NONQUALIFIED
Contributions currently TAX DEDUCTIBLE	Contributions NOT currently TAX DEDUCTIBLE
Plan APPROVED by the IRS	Plan DOES NOT NEED IRS APPROVAL
Plan CANNOT DISCRIMINATE	Plan CAN DISCRIMINATE
Earnings grow TAX DEFERRED	Earnings grow TAX DEFERRED
ALL WITHDRAWALS are TAXED	EXCESS over cost basis is TAXED

2. Individual Qualified Plans - IRA and Roth IRA

The 2 most common qualified individual retirement plans are Traditional IRAs and Roth IRAs. Anybody with **earned income** can contribute to either plan.

A Traditional **Individual Retirement Account (IRA)** allows individuals to make tax deductible contributions until the age of 70 ½. Plan participants are allowed to contribute up to a specified dollar limit each year, or 100% of their salary if less than the maximum allowable amount. Individuals who are **age 50 or older** are entitled to make additional *catch-up* contributions. A *married couple* could contribute a specified amount that is double the individual amount, even if only one person had earned income. Each spouse is required to maintain a separate account not exceeding the individual limit. In traditional IRAs, withdrawals may begin at age 59 ½, but no later than age 70 ½.

The **Roth IRA** is a form of an individual retirement account funded with after-tax contributions. An individual can contribute 100% of earned income up to an IRS-specified maximum, as with traditional IRAs (the dollar amounts change every year). In contrast with a traditional IRA, Roth contributions can continue beyond age 70½ and distributions do not have to begin at age 70½. Roth IRAs grow tax free as long as the account is open for at least 5 years.

Taxation of IRAs and Roth IRAs

The following taxation rules apply to **contributions** made to traditional IRA plans:

- Tax-deductible contributions for the year of the contribution (based on the person's income);
- Contributions must be made in **"cash"** in order to be tax deductible (the term *cash* includes any form of money, such as cash, check, or money order);
- Excess contributions are taxed at 6% per year as long as the excess amounts remain in the IRA;
- Tax-deferred earnings (the money that accumulates in the account) are not taxed until withdrawn.

A **distribution** from an IRA is subject to income taxation in the year the withdrawal is made. In case of an early distribution (prior to age 59 ½), a 10% penalty will also apply.

There are certain conditions, under which the 10% penalty for early withdrawals would not apply (penalty tax exceptions):

- Participant is age 59½;
- Participant is totally disabled;
- The money is used to make the down payment on a home (not to exceed $10,000, and usually for first-time homebuyers);
- Withdrawals are for post-secondary education expenses; and
- Withdrawals are for catastrophic medical expenses, or upon death.

The following taxation rules apply to Roth IRAs:

- Contributions are not tax deductible;
- Excess contributions are subject to a 6% tax penalty.

TRADITIONAL IRA	ROTH IRA
Contribute 100% of income up to an IRS-specified limit	
Excess contribution penalty is 6%	
Grows tax deferred	Grows tax free (if account open for at least 5 years)
Contributions are **tax deductible** (Made with "pre-tax dollars")	Contributions are **not tax deductible** (Made with "after-tax dollars")
10% penalty for early nonqualified distributions prior to age 59 ½ (some exceptions apply) Distributions are **taxable**	Qualified distribution cannot occur until account is open for 5 years and owner is 59½ Distributions are **not taxable**
Payouts must begin by 70½	Payouts don't have to begin by 70½

ROLLOVERS AND TRANSFERS

Situations exist in which a person may choose to move the monies from one qualified retirement plan to another qualified retirement plan. However, benefits that are withdrawn from any qualified retirement plan are taxable the year in which they are received if the money is not moved properly. There are 2 ways to accomplish this: a **rollover** and a **transfer** from one account to another.

A **rollover** is a tax-free distribution of cash from one retirement plan to another. Generally, IRA rollovers must be completed within 60 days from the time the money is taken out of the first plan. If the distribution from the first plan is paid *directly to the participant*, 20% of the distribution must be withheld by the payor. The 20% withholding of funds can be avoided if the distribution is made *directly from the first plan to the trustee or administrator/custodian of the new IRA plan.* This is known as **direct rollover**.

The term **transfer (or direct transfer)** refers to a tax-free transfer of funds from one retirement program to a traditional IRA or a transfer of interest in a traditional IRA **from one trustee directly to another**.

3. PLANS FOR EMPLOYERS

In addition to individual plans, different types of qualified plans are available and have been designed for use by small and large employers.

SELF-EMPLOYED PLANS (HR-10 OR KEOGH)

HR-10 or Keogh plans make it possible for **self-employed persons** to be covered under an IRS qualified retirement plan. These plans allow the self-employed individuals to fund their retirement programs with pre-tax dollars as if under a corporate retirement or pension plan. To be covered under a Keogh retirement plan, the person must be self-employed or a partner working part time or full time who owns at least 10% of the business.

Contribution limits are the lesser of an established dollar limit or 100% of their total earned income. The contribution is tax deductible, and it accumulates tax deferred until withdrawal.

Upon a participant's death, payouts can be available immediately. If a participant becomes disabled, he or she may collect benefits immediately or the funds can be left to accumulate. When a participant enters retirement, distribution of funds must occur no earlier than 59½ and no later than 70½. If withdrawn before 59½, there is a 10% penalty. At any time payments may be discontinued with no penalty, and funds can be left to accumulate.

Under eligibility requirements, any individual who is at least 21 years of age, has worked for a self-employed person for one year or more, and worked at least 1,000 hours per year (full time) must be included in the Keogh Plan. The employer must contribute the same percentage of funds into the employee's retirement account as he/she contributes into his/her own account.

Simplified Employee Pension Plans (SEP)

A Simplified Employee Pension (SEP) is a type of qualified plan suited for the small employer or for the self-employed. In a SEP, an employee establishes and maintains an individual retirement account to which the employer contributes. Employer contributions are not included in the employee's gross income. The primary difference between a SEP and an IRA is the much larger amount that can be contributed each year to a SEP (an IRS established annual dollar limit or 25% of the employee's compensation, whichever is less).

SIMPLE Plans

A SIMPLE *(Savings Incentive Match Plan for Employees)* plan is available to small businesses that employ **no more than 100 employees** who receive at least $5,000 in compensation from the employer during the previous year. To establish a SIMPLE plan, the employer must not have a qualified plan already in place. Employees who elect to participate may defer up to a specified amount each year, and the employer then makes a matching contribution, dollar for dollar, up to an amount equal to 3% of the employee's annual compensation. **Taxation is deferred** on both contributions and earnings until funds are withdrawn.

Profit Sharing and 401(k) Plans

Profit-sharing plans are qualified plans where a portion of the company's profit is contributed to the plan and shared with employees. If the plan does not provide a definite formula for figuring the profits to be shared, employer contributions must be **systematic and substantial**.

A 401(k) qualified retirement plan allows employees to take a reduction in their current salaries by deferring amounts into a retirement plan. The company can also match the employee's contribution, whether it is dollar for dollar or on a percentage basis. Under a 401(k) plan, participants may choose to either receive taxable cash compensation or have the money contributed into the 401(k), referred to as *cash or deferred arrangement plans* (CODA). Contributions into the plan are excluded from the individual employee's gross income up to a dollar ceiling amount. The ceiling amount is adjusted annually for inflation. The plan allows participants age 50 or over to make additional catch-up contributions (up to a limit) at the end of the calendar year.

Plans permit early withdrawal for specified hardship reasons such as death or disability. Loans are also permitted in certain instances up to 50% of the participant's vested accrued benefit or a specified dollar limit *(set by the IRS annually).*

403(B) TAX-SHELTERED ANNUITIES (TSAS)

A 403(b) plan or a tax-sheltered annuity (TSA) is a qualified plan available to employees of certain **nonprofit organizations** under **Section 501(c)(3)** of the Internal Revenue Code, and to employees of public school systems.

Contributions can be made by the employer or by the employee through salary reduction and are excluded from the employee's current income. As with any other qualified plan, 403(b) limits employee contributions to a maximum amount that changes annually, adjusted for inflation. The same catch-up provisions also apply.

	HR-10 Keogh	SEP	SIMPLE	401(k)	403(b) - TSA
Eligibility	Self-employed	Small employer or self-employed	Small employers (no more than 100 employees)	Any employer	Nonprofits
Who contributes	Employer matches employee's contributions	Employee and employer	Employer matches employee's contribution	Employer matches employee's contribution	Employer and employee

F. LIFE INSURANCE NEEDS AND ANALYSIS/SUITABILITY

1. PERSONAL USES

SURVIVOR PROTECTION

The death of the primary wage-earner will usually stop the flow of income to a family. The death of a nonearning spouse who cares for minor children can also cause great financial hardship for the survivors. Life insurance can provide the funds necessary for the survivors of the insured to be able to maintain their lifestyle in the event of the insured's death. This is known as **survivor protection.** Planning for survivor protection requires careful examination of current assets and liabilities as well as determining what survivors' needs may be.

ESTATE CREATION

A person may create an estate through earnings, savings, and investments, but all of these methods require disciplined action and a significant period of time. The purchase of life insurance **creates an immediate estate**. Estate creation is especially important for young families that are getting started and have not yet had time to accumulate assets. When an insured purchases a life insurance policy, he/she will have an estate of at least that amount the moment the first premium is paid. There is no other legal method by which an immediate estate can be created at such a small cost.

CASH ACCUMULATION

Life insurance may be used to accumulate specific amounts of monies for specific needs with guarantees that the money will be available when needed. *For example*, some life policies (those that provide permanent protection, such as whole life) accumulate cash value that is available to the policyowner during the policy term.

LIQUIDITY

As a result of the cash accumulation feature, some life insurance policies provide **liquidity** to the policyowner. That means the policy's cash values can be borrowed against at any time and used for immediate needs.

ESTATE CONSERVATION

Life insurance proceeds may be used to pay inheritance taxes and federal estate taxes so that it is not necessary for the beneficiaries to sell off the assets.

2. BUSINESS INSURANCE NEEDS

Businesses use life insurance for the same reason individuals use life insurance: it creates an immediate payment upon the death of the insured.

The most common use of life insurance by businesses is as an employee benefit, which serves as a protection for employees and their beneficiaries. There are also other forms of life insurance that can serve business owners and their survivors, and even protect the business itself. These include funding business continuation agreements, compensating executives, and protecting the business against financial loss resulting from the death or disability of key employees.

KEY PERSON

A business can suffer a financial loss because of the premature death of a key employee — someone who has specialized knowledge, skills or business contacts. A business can lessen the risk of such loss by the use of **key person insurance**.

With this coverage, the **key employee is the insured**, and the business is all of the following:

- Applicant;
- Policyowner;
- Premium payer; and
- Beneficiary.

In the event of death of a key employee, the business would use the money for the additional costs of running the business and replacing the employee. The business cannot take a tax deduction for the expense of the premium. However, if the key employee dies, the benefits paid to the business are usually received tax free. No special agreements or contracts are needed except that the employee(s) would need to give permission for this coverage.

BUY-SELL FUNDING

A **buy-sell** agreement is a legal contract that determines what will be done with a business in the event that an owner dies or becomes disabled. This is also referred to as a *business continuation agreement*.

There are several types of buy-sell agreements that can be used for partnerships and corporations:

- **Cross Purchase** — used in partnerships when each partner buys a policy on the other;
- **Entity Purchase** — used when the partnership buys the policies on the partners;
- **Stock Purchase** — used by privately owned corporations when each stockholder buys a policy on each of the others;
- **Stock Redemption** — used when the corporation buys one policy on each shareholder.

Example:

Here is an example of a cross-purchase buy-sell agreement: Partnership AB has two partners, A and B. The value of the business is $1,000,000. The partners each have an equal interest ($500,000 each). A buys a life policy on B for $500,000, and B buys a life policy on A for $500,000. If A dies, B gets 100% ownership of the business and A's heirs receive $500,000.

G. TAXATION OF LIFE INSURANCE

Generally speaking, the following taxation rules apply to life insurance policies:

- **Premiums** are not tax deductible;
- **Death benefit:**
  - Tax free if taken as a lump-sum distribution to a named beneficiary;
  - Principal is tax free; interest is taxable if paid in installments (other than lump sum).

1. AMOUNTS AVAILABLE TO POLICYOWNERS

As you have already learned, permanent life insurance provides living benefits. There are several ways in which policyowners may receive those living benefits from the policy.

DIVIDENDS

Since dividends are a return of unused premiums, they are not considered income for tax purposes. When dividends are left with the insurer to accumulate interest, the interest earned on the dividend account is subject to taxation as ordinary income each year interest is earned, whether or not the interest is paid out to the policyowner.

CASH VALUE ACCUMULATIONS

Any cash value accumulations in the policy can be borrowed against by the policyowner, or may be paid to the policyowner upon surrender of the policy. Cash values grow tax deferred. Upon surrender or endowment, any cash value in excess of cost basis (premium payments) is taxable as ordinary income. Upon death, the face amount is paid, and there is no more cash value. Death benefits generally are paid to the beneficiary income tax free.

POLICY LOANS

The policyowner may borrow against the policy's cash value. Money borrowed against the cash value is not income taxable; however, the insurance company charges interest on outstanding policy loans. Policy loans, with interest, can be repaid in any of the following ways:

- By the owner while the policy is in force;
- At policy surrender or maturity, subtracted from the cash value; or
- At the insured's death, subtracted from the death benefit.

SURRENDERS

When a policyowner surrenders a policy for cash value, some of the cash value received may be taxable as income if the cash surrender value exceeds the amount of the premiums paid for the policy. When the owner withdraws cash value from a universal life policy (partial surrender), both the cash value and the death benefit are reduced by the surrender.

Example:

Consider the following scenario:

- Face amount: $300,000
- Premiums paid: $70,000
- Total cash value: $100,000

If the insured surrendered $30,000 of cash value, the full $30,000 would be income tax free. If the insured took out $100,000, the last $30,000 would be taxable because the $100,000 exceeds the premiums that were paid in by $30,000.

ACCELERATED BENEFITS

When accelerated benefits are paid under a life insurance policy to a terminally ill insured, the benefits are received **tax free**. When accelerated benefits are paid to a chronically ill insured (*for example*, someone who has cancer, Alzheimer's disease or other severe illness), these benefits are tax free up to a certain limit. Any amount received in excess of this dollar limit must be included in the insured's gross income.

2. AMOUNTS RECEIVED BY BENEFICIARY

GENERAL RULE AND EXCEPTIONS

Life insurance proceeds paid to a named beneficiary are generally **free of federal income taxation** if taken as a lump sum. An exception to this rule would apply if the benefit payment results from a *transfer for value*, meaning the life insurance policy is sold to another party prior to the insured's death.

SETTLEMENT OPTIONS

With **settlement options**, when the beneficiary receives payments consisting of both principal and interest, the interest portion of the payments received is taxable as income.

Example:

If $100,000 of life insurance proceeds were used in a settlement option paying $13,000 per year for 10 years, $10,000 per year would be income tax free and $3,000 per year would be income taxable.

PERMANENT LIFE FEATURES	TAX TREATMENT
Premiums	Not tax deductible
Cash value exceeding premiums paid	Taxable at surrender
Policy loans	Not income taxable
Policy dividends	Not taxable
Dividend interest	Taxable in the year earned
Lump-sum death benefit	Not income taxable

3. Group Life and Employer-sponsored Plans

The **premiums** that an employer pays for life insurance on an employee, whereby the policy is for the employee's benefit, **are tax deductible to the employer** as a business expense. If the group life policy coverage is $50,000 or less, the employee does not have to report the premium paid by the employer as income (not taxable to the employee).

Any time a business is the named beneficiary of a life insurance policy, or has a beneficial interest in the policy, any premiums that the business pays for such insurance are not tax deductible. Therefore, when a business pays the premiums for any of the following arrangements, the premiums are not deductible:

- Key-employee (key-person) insurance;
- Stock redemption or entity purchase agreement;
- Split-dollar insurance.

The **cash value** of a business owned life insurance policy or an employer provided policy accumulates on a tax-deferred basis and is taxed in the same manner as an individually owned policy.

Policy loans are not taxable to a business. Unlike an individual taxpayer, a corporation may deduct interest on a life insurance policy loan for loans up to $50,000.

Policy death benefits paid under a business owned or an employer provided life insurance policy are received income tax free by the beneficiary (in the same manner as in individually owned policies).

If the general requirements for qualified plans are met, the following tax advantages apply:

- Employer contributions are tax deductible to the employer, and are not taxed as income to the employee;
- The earnings in the plan accumulate tax deferred;
- Lump-sum distributions to employees are eligible for favorable tax treatment.

H. Modified Endowment Contracts (MECs)

Following the elimination of many traditional tax shelters by the Tax Reform Act of 1984, single premium life insurance remained as one of the few financial products offering significant tax advantages. Consequently, many of these types of policies were purchased solely for purposes of setting aside large sums of money for the tax-deferred growth as well as tax-free cash flow available via policy loans and partial surrenders.

To curtail this activity, and to determine if an insurance policy is overfunded, the Internal Revenue Service (IRS) established what is known as the **7-pay Test**. Any life insurance policy that fails a 7-pay test is classified as a **Modified Endowment Contract (MEC)**, and loses the standard tax benefits of a life insurance contract. In a MEC, the cumulative premiums paid during the first 7 years of the policy exceed the total amount of net level premiums that would be required to pay the policy up using guaranteed mortality costs and interest.

All life insurance policies are subject to the 7-pay test, and any time there is a material change to a policy (such as an increase in the death benefit), a new 7-pay test is required. Whether from a life insurance policy or a MEC, the death benefit received by the beneficiary is tax free.

The following are taxation rules that apply to MEC's cash value:

- Tax-deferred accumulations;
- Any distributions are taxable, including withdrawals and policy loans;
- Distributions are taxed on LIFO basis (Last In, First Out) - known as "interest-first" rule;
- Distributions before age 59 ½ are subject to a 10% penalty.

TAX CONSIDERATIONS FOR LIFE INSURANCE AND ANNUITIES	
Premiums	**Not deductible (personal expense)**
Death Benefit	**Not income taxable (except for interest)**
Cash Value Increases	**Not taxable (as long as policy in force)**
Cash Value Gains	**Taxed at surrender**
Dividends	**Not taxable (return of unused premium; however, interest is taxable)**
Accumulations	**Interest taxable**
Policy Loans	**Not income taxable**
Surrenders	**Surrender value - past premium = amount taxable**
Partial Surrenders	**First In, First Out (FIFO)***
Settlement Options—Death benefit spread evenly over income period (averaged). Interest payments in excess of death benefit portion are taxable.	
Estate Tax—If the insured owns the policy, it will be included for estate tax purposes. If the policy is given away (possibly to a trust) and the insured dies within 3 years of the gift, the death benefit will be included in the estate.	

**FIFO applies to Life insurance only. Annuities follow a LIFO format.*

I. SOCIAL SECURITY BENEFITS

Social Security, also referred to as **Old Age Survivors Disability Insurance** — OASDI, is a Federal program enacted in 1935, which is designed to provide protection for eligible workers and their dependents against financial loss due to old age, disability, or death. With a few exceptions, almost all individuals are covered by Social Security. In some aspects, Social Security plays a role of federal life and health insurance, which is important to consider when determining an individual's needs for life insurance.

Social Security uses the Quarter of Coverage (QC) system to determine whether or not an individual is qualified for Social Security benefits. The type and amount of benefits are determined by the amount of **credits** or **QCs** a worker has earned. Anyone working in jobs covered by Social Security or operating his/her own business may earn up to a maximum of 4 credits for each year of work.

The term **fully insured** refers to someone who has earned **40 quarters** of coverage (the equivalent of 10 years of work), and is therefore entitled to receive Social Security retirement, Medicare, and survivor benefits.

An individual can attain a **currently insured** status (or partially insured), and by that qualify for certain benefits if he or she has earned **6 credits** (or quarters of coverage) during the 13-quarter period *ending with the quarter in which the insured:*

- Dies;
- Becomes entitled to disability insurance benefits; or
- Becomes entitled to old-age insurance benefits.

For younger workers, the number of quarters required to qualify for the benefits differs by age according to a table established by Social Security.

Type of Benefit	Conditions for Payment	Paid to	Type of Payment	Worker's Status
Retirement Benefit	Fully insured status and age 66* (or reduced benefits at age 62)	Retired individual and eligible dependents	Monthly benefit equal to the primary insurance amount (PIA)	Fully insured
Disability Benefit	Total and permanent disability prior to the retirement age	Disabled worker and spouse and eligible dependents	Monthly disability benefit after a 5-month waiting period	Fully insured
Survivor Benefit	Worker's death	Surviving spouse and dependent children	Lump-sum burial benefit Monthly income payments	Fully or currently insured Fully insured

**The current full retirement age is 66, and is gradually increasing to age 67.*

J. Chapter Recap

Make sure you review the following key terms before moving on to the next chapter:

Basic Terms	Cash value accumulation Dividend Estate Interest Nonqualified plan Policy loan Principal Qualified retirement plan Settlement option Surrender Tax deductible Tax deferred Taxable

Types of Qualified Plans	HR-10 (Keogh) Simplified Employee Pension (SEP) Profit-sharing 401(k) Roth IRA SIMPLE (Savings Incentive Match Plan for Employees) Traditional IRA 403(b) Tax-sheltered Annuity (TSA)
Other Taxable Processes	Modified Endowment Contract (MEC) Rollover Transfer

This chapter continued the discussion about different types of life insurance products: group plans, third-party plans, and qualified and nonqualified plan options for individuals and businesses. You have also learned some basic principles of taxation for life insurance and annuities. Let's recap the major points:

THIRD-PARTY CONTRACTS	
General Features	• The policyowner and the insured are not the same person • Policies written for minors or for businesses
Viatical Settlements	• Viator is the insured who has a terminal illness • Viator receives a *percentage* of the policy's face amount
Life Settlements	• Policyowner sells the life policy that is no longer needed to a third party • Insured does not have to be terminally ill • Absolute assignment
GROUP LIFE INSURANCE	
General Features	• Employer is the policyowner (receives a master contract); employees are the insured (receive certificates of insurance) • No evidence of insurability • *Conversion* - no evidence of insurability, within a specified number of days (usually 30 or 31 days of termination) • *Noncontributory* - employer pays 100% of the premium; requires 100% employee participation • *Contributory* - employer and employees share the cost of premium; requires 75% participation
QUALIFIED PLANS	
General Features	• Approved by the IRS • Tax benefits for employers and employees • Must be permanent and have a vesting requirement • Cannot discriminate in favor of the prohibited group
Individual Qualified Retirement Plans	Traditional IRA: • Earned income • Pretax contributions • Contributions: - Age limit - 70 ½ - Dollar limit - up to a maximum allowed amount - Married couples - double the amount for singles • Withdrawals must begin at age 59 ½ and not later than 70 ½

Individual Qualified Retirement Plans *(continued)*	Roth IRA: • Earned income • After-tax contributions • Contributions: - Beyond age 70 ½ - Dollar limit - up to a maximum allowed amount • Withdrawals do not have to begin at age 70 ½
Employer-sponsored Qualified Plans	• Contributions up to an IRS-specified amounts • Both employer and employee can contribute Types of plans: • *HR-10 (Keogh)* - self-employed • *SEP* - small employer/self-employed; employer funds employee's IRA • *SIMPLE* - small employer (no more than 100 employees); set up as IRA or as 401(k) • *401(k)* - any employer; cash or deferred arrangements; profit sharing • *403(b)* - nonprofit organizations; a tax-sheltered annuity
TAXATION	
Life Insurance	• *Premiums* - not tax deductible • *Cash value* - taxable only if the amount exceeds premiums (taxed on gain) • *Policy loans* - not taxable, interest not tax deductible • *Dividends* - not taxable as return of premium; any interest is taxable • *Death benefit* - not taxable if lump-sum; any interest is taxable
IRAs	• *Contributions* - pretax dollars, tax deductible, must be made in "cash" • *Earnings* - tax deferred • *Distributions* - taxable; 10% penalty for early withdrawals
Roth IRAs	• *Contributions* - after-tax dollars, not tax deductible • *Distributions* - not taxable
Business Insurance	• Employer contributions: - Tax deductible to the employer - Not taxed as income to the employee - The earnings grow tax deferred • Lump-sum distributions to employees have favorable tax treatment
OTHER RELATED CONCEPTS	
Rollovers and Transfers	• Tax-free transactions • Distribution of money from one qualified retirement plan to another • Must be completed within 60 days • If from plan to the participant, 20% of distribution is withheld • If from plan to trustee, no withholdings (direct rollover)
Modified Endowment Contract (MEC)	• Overfunded life insurance policy (7-pay test) • *Accumulation* - tax deferred • *Distributions* - taxable Last In, First Out • Distributions before age 59 ½ - 10% penalty

SOCIAL SECURITY BENEFITS	
Types of Benefits	• Retirement • Disability • Survivor
Insured Status	• *Fully insured* (40 quarters of coverage) - qualify for Social Security retirement, Medicare, and survivor benefits • *Currently insured* (6 quarters of coverage) - qualify for some benefits

K. Chapter Quiz - Taxes, Retirement, and Other Insurance Concepts

1. Generally, the premium paid for personal life insurance is

A. Fully tax deductible.
B. Partially tax deductible.
C. Not tax deductible.
D. Taxed.

2. Which of the following is NOT true regarding policy loans?

A. Money borrowed from the cash value is taxable.
B. Policy loans can be repaid at death.
C. An insurer can charge interest on outstanding policy loans.
D. A policy loan may be repaid after the policy is surrendered.

3. Which of the following is NOT a requirement of a qualified plan?

A. It must be temporary.
B. It must have a vesting schedule.
C. It cannot discriminate in favor of highly paid employees.
D. It must be written and communicated to all participants.

4. If a life policy does not pass the 7-pay test, that policy

A. Must be canceled.
B. Becomes a Modified Endowment Contract.
C. Is considered a Limited-Pay policy.
D. Must increase its premiums for additional 7 years.

5. The 10% early withdrawal penalty from an IRA can be waived for

A. Catastrophic medical expenses.
B. Any type of diszability.
C. Withdrawals at age 55.
D. A down payment under $10,000 on a second home.

6. The number of credits required to obtain a fully insured status to receive Social Security benefits is

A. 6
B. 10
C. 13
D. 40

7. All of the following persons who do not have an employer-sponsored retirement plan would be eligible to set up contributions to a traditional IRA EXCEPT

A. Jason, age 26, an independent contractor.
B. Arlene, age 72, a nurse.
C. Marsha, age 40, a proofreader.
D. Tom, age 60, a mechanic.

8. What is the requirement for a number of employees in a SIMPLE plan?

A. 100 or more
B. 50 or fewer employees
C. No more than 100
D. At least 50

9. The advantage of qualified plans to employers is

A. Tax-deductible contributions.
B. Tax-free earnings.
C. No lump-sum payments.
D. Taxable contributions.

10. With personal life insurance, the lump-sum death benefit is received by the beneficiary

A. Income tax free.
B. On a last-in-first-out basis.
C. As taxable income.
D. With taxable interest.

11. In group life policies, individual certificates are given to

A. The policyholder to keep on file.
B. Each insured person.
C. The group sponsor.
D. The insurance producer.

12. Which of the following insurance arrangements will be appropriate for a business purchasing life insurance on its general manager?

A. A buy-sell agreement
B. An irrevocable beneficiary
C. Third-party ownership
D. A modified endowment contract

13. Which of the following are Social Security benefits?

A. Workers compensation and unemployment
B. Accidental death and dismemberment
C. Retirement, disability, and survivors
D. Accelerated death benefit

14. A key-person insurance policy benefit will pay for which of the following?

A. Loss of personal income
B. Workers compensation
C. Hospital bills of the key employee
D. Cost of training a replacement

15. An employee quits his job and converts his group insurance to an individual policy. On which of the following will the premium for the individual policy be based?

A. Experience rating
B. Original group rate
C. Insured's income
D. Insured's attained age

Answers to the quiz may be found in Appendix A.

FLASHBACK

Test your retention of the new concepts you learned. **Flashback** to the beginning of the chapter to review the **Snapshots** before moving forward.

V

TEXAS STATUTES AND RULES COMMON TO LIFE AND HEALTH INSURANCE

V. Texas Statutes and Rules Common to Life and Health Insurance

INTRO

Up to this point, the concepts that you have covered have been ones that apply to the insurance industry as a whole. Now that you have examined insurance policies and their provisions, you can turn your attention to regulations and definitions that apply only to this state. You'll learn about a variety of topics, from the duties of the Insurance Department to licensing laws.

SNAPSHOTS

1. What is included under the term insurance transaction?
2. What is the difference between domestic, foreign and alien insurance companies?
3. What is the difference between an authorized/admitted and unauthorized/nonadmitted insurer?
4. What document must an insurance company hold to transact insurance business in Texas?
5. What are the duties of the Commissioner?
6. When can the Commissioner examine an insurer's or agent's records?
7. What factors help determine the amount of an administrative penalty?
8. Who do agents represent?
9. How long can a temporary license be in effect?
10. How often are producers required to renew their license?
11. If a producer's license has been revoked, how long must the producer wait before reapplying for a new license?
12. What constitutes rebating?
13. Can agents or insurers advertise protection by the Insurance Guaranty Association?

EXAM BREAKDOWN

See where to spend your valuable study time! Check out the **Exam Breakdown** at the beginning for chapter percentages.

TERMS TO KNOW

Cease and desist — to stop or discontinue
Coercion — forceful act or threat aimed to influence a person to act against his or her will
Commission — payment to the agent by the insurance company for placing insurance, usually a percentage of the policy premium
Commissioner — the head of the State Department of Insurance
Exempt — not subject to an obligation
Home office — insurer's headquarters, principal place of business
Inducement — an offer that attempts to influence the other party
Insolvent — unable to meet financial obligations
Moral turpitude — conduct that is contrary to community standards of justice, honesty or good morals
Reciprocity — a mutual interchange of rights and privileges
Restitution — restoration to the original condition or repayment
Statute — a formal written law enacted by legislature; insurance statutes can be found in the state Insurance Code

A. DEFINITIONS

1. TRANSACTING INSURANCE

The term **insurance transaction** includes any of the following (by mail or any other means):

- Solicitation;
- Negotiations;
- Sale (effectuation of a contract of insurance);
- Advising an individual concerning coverage or claims.

The following acts, when performed by insurers or agents, constitute the **business of insurance** in this state:

- Making or proposing to make an insurance contract;
- Taking or receiving an insurance application;
- Receiving or collecting any consideration for insurance, including a premium, a commission, a membership fee, an assessment, or dues;
- Issuing or delivering an insurance contract;
- Directly or indirectly acting as an agent for an insurer; or
- Doing any kind of insurance business specifically recognized as constituting insurance business within the statutes of the Insurance Code.

2. TYPES OF INSURERS

The **insurer** (or principal) is the company or organization that issues a policy of insurance.

Insurance companies can be classified in a variety of ways based on ownership, authority to transact business, location of incorporation (domicile), marketing and distribution systems, or rating (financial strength).

As you read about different classifications of insurers, keep in mind that these categories are not mutually exclusive, and the same company can be described based on where it is located and allowed to transact the business of insurance, who owns it, and what type of agents it appoints.

OWNERSHIP

The following are the most common types of ownership.

STOCK COMPANIES

Stock companies are owned by the stockholders who provide the capital necessary to establish and operate the insurance company and who share in any profits or losses. Officers are elected by the stockholders and manage stock insurance companies. Traditionally, stock companies issue **nonparticipating** policies, in which policyowners do not share in profits or losses.

A nonparticipating (stock) policy does not pay dividends to policyowners; however, taxable dividends are paid to stockholders.

MUTUAL COMPANIES

Mutual companies are owned by the policyowners and issue **participating** policies. With participating policies, policyowners are entitled to dividends, which, in the case of mutual companies, are a return of excess premiums and are therefore **nontaxable**. Dividends are generated when the premiums and the earnings combined exceed the actual costs of providing coverage, creating a surplus. Dividends are not guaranteed.

FRATERNALS

A **fraternal benefit society** is an organization formed to provide insurance benefits for members of an affiliated lodge, religious organization, or fraternal organization with a representative form of government. Fraternals sell only to their members and are considered charitable institutions, and *not insurers.* They are not subject to all of the regulations that apply to the insurers that offer coverage to the public at large.

DOMESTIC, FOREIGN AND ALIEN INSURERS

Insurance companies are classified according to the **location of incorporation** (domicile). Regardless of where an insurance company is incorporated, it must obtain a Certificate of Authority before transacting insurance within the state.

A **domestic** insurer is an insurance company that is incorporated in this state. In most cases, the company's home office is in the state in which it was formed — the company's domicile. *For instance,* a company chartered in Pennsylvania would be considered a Pennsylvania domestic company.

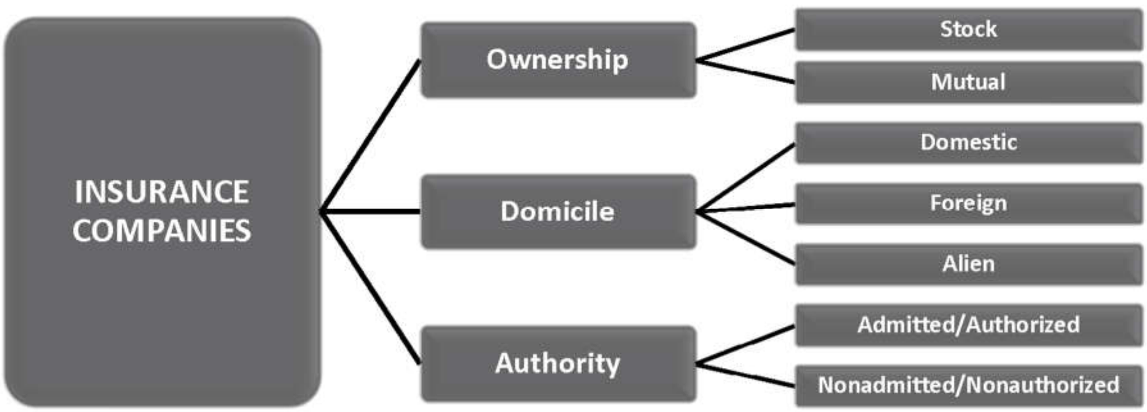
A **foreign** insurer is an insurance company that is incorporated in another state or territorial possession (such as Puerto Rico, Guam or American Samoa). *For example,* a company chartered in California would be a foreign company within the state of New York.

An **alien** insurer is an insurance company that is incorporated outside the United States.

CERTIFICATE OF AUTHORITY

Before insurers may transact business in a specific state, they must apply for and be granted a license or **Certificate of Authority** from the state department of insurance and meet any financial (capital and surplus) requirements set by the state. Insurers who meet the state's financial requirements and are approved to transact business in the state are considered **authorized or admitted** into the state as a legal insurer. Those insurers who have not been approved to do business in the state are considered **unauthorized or nonadmitted**. Most states have laws that prohibit unauthorized insurers from conducting business in the state, except through licensed excess and surplus lines brokers.

An insurance company must hold a **certificate of authority** issued by the Commissioner in order to transact insurance business in Texas. The certificate remains in effect until it is revoked, canceled, or suspended. If an insurer fails to file an annual statement required by law, the insurer's certificate of authority may be suspended or revoked by the Department.



B. COMMISSIONER OF INSURANCE

1. GENERAL POWERS AND DUTIES

The Commissioner is the chief executive and administrative officer of the state Department of Insurance. The Commissioner must be a citizen of the state of Texas, be well informed and qualified in the field of insurance and insurance regulation, and have at least **5 years** of experience in the administration of business or government or as a practicing attorney or certified public accountant. The Commissioner is appointed by the Governor for a **2-year** term ending on February 1 of each odd-numbered year.

The Commissioner has the following broad powers and duties:

- Regulate the internal affairs of the Department of Insurance;
- Prescribe forms and procedures to be followed in proceedings before the Department;
- Aid in the interpretation of any state insurance law;
- Issue insurance licenses and certificates of authority;
- Enforce penalties, fines, denials, suspensions or revocations of licensees and certificates of authority.

EXAMINATION OF RECORDS

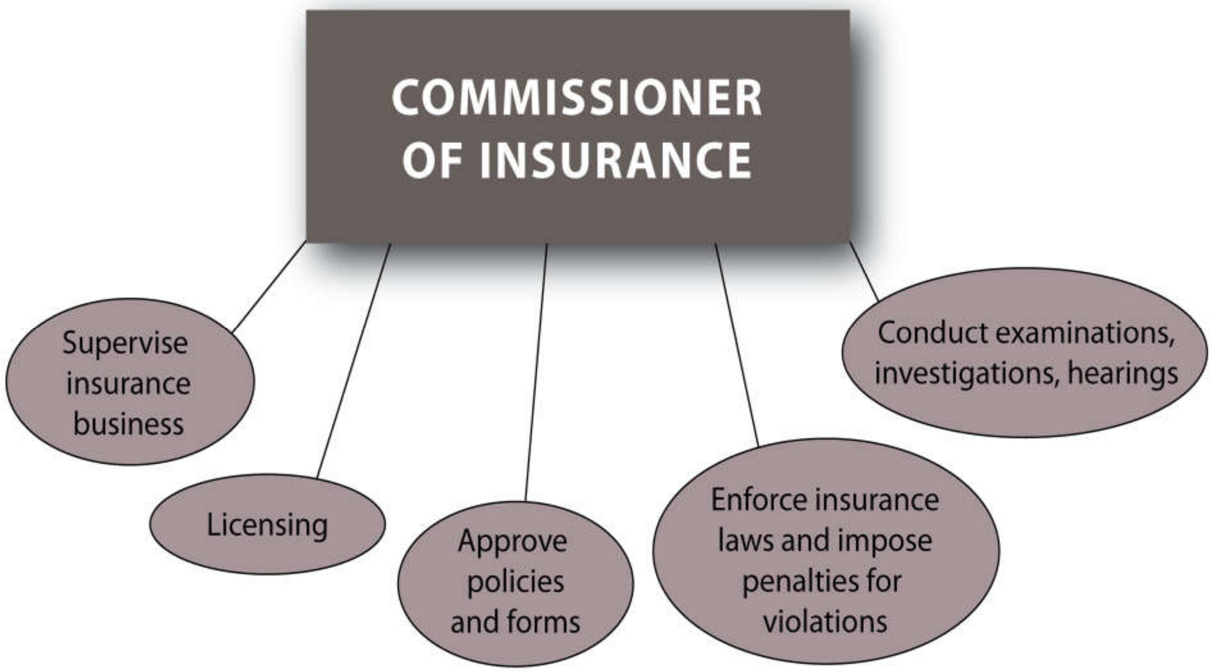
The Commissioner regulates insurance companies authorized to do business in this state. The purpose of the examination of insurers' books and records is to ensure that the companies remain solvent and conduct business in compliance with state laws and regulations pertaining to licensing, policy forms, rates, claims, and market conduct.

The Commissioner must examine all authorized insurers at least once **every 5 years.** This examination requirement applies to all domestic insurers (organized under Texas laws), as well as admitted foreign and alien insurers.

The cost of examinations is the responsibility of the insurance company being examined.

COMPLAINTS

The Commissioner and the Department are required to establish a program to facilitate resolution of policyowner complaints. If the department receives a written complaint, they will notify each party of the complaint's status at least quarterly. The department must also keep an information file about each complaint filed with the department.



2. INVESTIGATIONS, HEARINGS, AND PENALTIES

Because the Commissioner's role is to enforce insurance laws and to protect the public from unfair trade practices, if the Commissioner suspects that an insurer or its agent has committed a violation or is engaged in an unfair trade practice, the Commissioner may issue a **statement of charges** and **hold a hearing** for any purpose deemed necessary (within the scope of the Insurance Code).

The Commissioner may not hold the hearing before the 6th day after the date the notice is served.

If the Commissioner believes any licensed agent is engaged in any form of unfair method of competition or trade practice, or that an unlicensed person is engaging in the sale of insurance, the Commissioner may issue an **emergency cease and desist order,** served by registered or certified mail. The order must state the charges and require the person to immediately stop committing the acts, methods or practices in violation. The order must also explain the rights of the person charged with the order.

The person charged may request a hearing to contest or review the charges. The request must be made **within 30 days** of the emergency cease and desist order. The hearing to show cause why the emergency cease and desist order should not be affirmed or modified must be held **no later than the 10th day after** the date the Commissioner receives the request for a hearing unless the parties mutually agree to a later date. (The emergency cease and desist order remains in effect until the hearing is held.)

After a hearing, the department will determine whether the method of competition or the act or practice considered in the hearing is an unfair method of competition or a false, misleading, or deceptive act or practice. The department will also determine if the person against whom the charges were made engaged in the method of competition or act or practice in violation of the Insurance Code or the Business and Commerce Code.

On determining that a person committed such a violation, the Department will make written findings, and issue and serve on the person a **cease and desist order**. The agent must appeal to the court system if he or she disagrees with the order. (Note that this cease and desist order is different from the emergency cease and desist order as it comes after a hearing has determined the person charged to be guilty of the violation.)

If a person refuses to comply with a subpoena issued in connection with a hearing, a district court in the county in which the person resides may order the person to comply with the subpoena or testify. If a person refuses to comply with a subpoena, the court may punish the person's failure to obey as **contempt**.

A person who **violates a cease and desist order** of the Commissioner will be subject to an administrative penalty:

- $1,000 for each violation; or
- $5,000 for all violations.

If a person has been found by a court to have violated a cease and desist order, that person must pay a civil penalty of $50 or $500 for willful violations. The state may recover the penalty in a civil action.

In addition to the suspension or revocation of a license, the Commissioner may impose *any* or *all* of the following penalties:

- Order the payment of an administrative penalty;
- Order the licensee to make restitution.

The Commissioner may order the licensee to make complete restitution to each Texas resident, each Texas insured, and each entity operating in this state that is harmed by a violation of or failure to comply with the Insurance Code or a rule of the Commissioner. The licensee must make the restitution in the form and amount and within the period determined by the Commissioner.

The Commissioner may impose an administrative penalty on a licensee who violates any of the following:

- The Insurance Code;
- Another insurance law of this state; or
- A rule or order adopted under the Insurance Code or another insurance law of this state.

The penalty for a violation may not exceed $25,000, unless a greater or lesser penalty is specified by the Insurance Code or another insurance law. The Commissioner will notify other state Commissioners or similar officers of penalties handed out. The amount of the penalty is based on the following factors:

- The seriousness of the violation, including the nature, circumstances, extent, and gravity of the violation, and the hazard or potential hazard created to the health, safety, or economic welfare of the public;
- The economic harm to the public interest or public confidence caused by the violation;
- The history of previous violations;
- The amount necessary to deter a future violation;
- Efforts to correct the violation;
- Whether the violation was intentional; and
- Any other matter that justice may require.

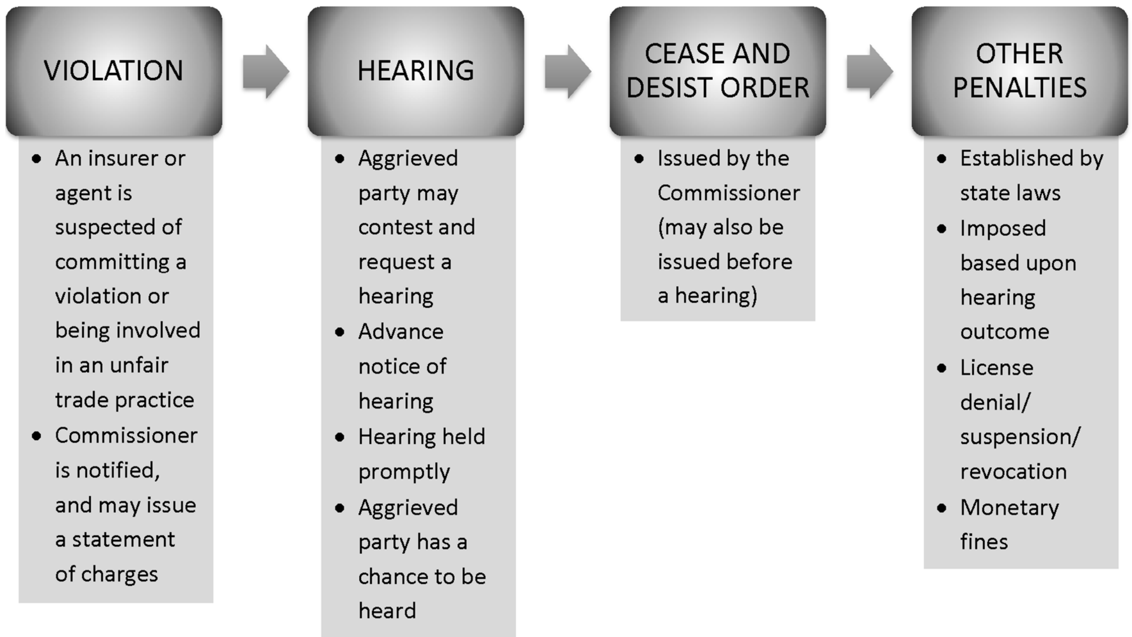
After determining that a violation has occurred, the department may issue a report to the Commissioner, stating the facts on which the determination is based and the department's recommendation on the imposition of an administrative penalty, including a recommendation on the amount of the penalty. The department must give written notice of the report to the affected person no later than 14 days after the date the report is issued. This notice must include a brief summary of the alleged violation and a statement of the amount of the recommended penalty. The notice must also inform the person that he/she has a **right to a hearing** on the occurrence of the violation, the amount of the penalty, or both. The person has 20 days from receiving the notice to accept the determination and recommended penalty or to request a hearing.

After a hearing, the Commissioner will, by order, find that a violation occurred and impose an administrative penalty, or find that a violation did not occur. Notice of the Commissioner's order must include a statement of the person's right to judicial review of the order. No later than 30 days after the date the Commissioner's order becomes final, the person must pay the penalty, or file a petition for judicial review.

In addition to any other remedy available for a violation of the Insurance Code, another insurance law of this state, or a rule of the Commissioner, the department may

- Deny an application for an original license;
- Suspend, revoke, or deny renewal of a license;
- Place on probation a person whose license has been suspended;
- Assess an administrative penalty; or
- Reprimand a license holder.

Violations and Penalties



3. Summary of State Regulations

STATE REGULATIONS	
2 years	Commissioner's term of office
5 years	Administration, attorney, or CPA experience required before applying to become the Commissioner
5 years	Commissioner must conduct annual examinations of authorized insurers
30 days	For agent to request a hearing after receiving a cease and desist order
10 days	Commissioner to hold the hearing after receiving the request
15 days	For insurers to begin settlement of claims

C. Licensing Requirements

1. General Provisions

Any person who solicits insurance on behalf of any insurance company, takes or transmits (other than for himself or herself) an insurance application or policy, examines any risk or loss, or receives, collects, or transmits any premium, is considered to be the **agent** of the company for which the act is done. Agents are normally compensated by commissions, where a percentage of the premium is paid to the agent by the insurance company.

2. Process

Applicants for an original insurance agent license in Texas must submit the required written application and nonrefundable filing fee (up to $50) to the Commissioner. The application must include the applicant's full name, age, occupation, place of residence and business for the past 5 years and a statement as to whether the applicant has ever held a license before, been refused a license or had one revoked. The Department of Insurance can deny an application if a complete set of fingerprints is not provided upon request.

The Department can issue a license to an individual applicant who meets all of the following requirements:

- Is at least 18 years old;
- Has passed the required licensing examination in the last 12 months*;
- Has submitted the application, required fees, and any other required information required by the Department; and
- Has not committed any acts for which a license may be denied.

*The following applicants are not required to take an examination:

1. The application is for the renewal of an unexpired license issued by the Department;
2. The applicant's license expired less than 1 year before the date of application and if the previous license was not denied, revoked, or suspended;
3. The applicant is a partnership, corporation, or depository institution;
4. An applicant applying for a life, accident, and health license is designated as a chartered life underwriter (CLU);
5. An applicant applying for a life and health counselor license is designated as a chartered life underwriter (CLU), chartered financial consultant (ChFC), or certified financial planner (CFP);
6. An applicant applying for a property and casualty license is designated as a chartered property casualty underwriter (CPCU);
7. A nonresident individual who is exempt from the examination under the regulations for nonresident producers;
8. An applicant for a general life, accident, and health license or a life agent license who was authorized to solicit insurance on behalf of a fraternal benefit society.

A license to which these exemptions apply must be held by the applicant in an individual capacity and is not transferable.

EXEMPTIONS/EXCEPTIONS

An insurance agent license is not required of any officer, director or employee of an insurer or organizations employed by insurers, provided they are not directly or indirectly involved with the actual sale of an insurance contract and **do not receive any commission**.

Furthermore, the following individuals are NOT required to hold an insurance producer license:

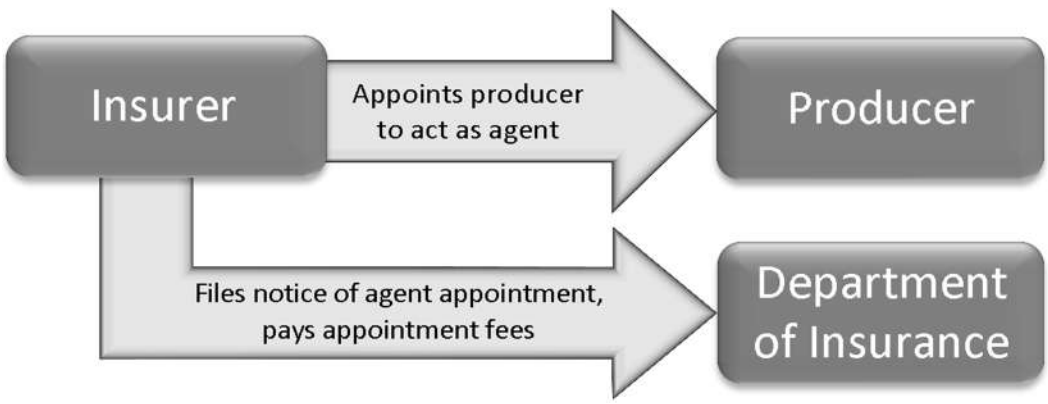
- A director or employee of an insurer whose activities are limited to executive, administrative, managerial, or clerical;
- The director or employee of a special agent assisting insurance producers by providing technical advice and assistance to licensed insurance producers;
- A person who secures and furnishes information for group insurance or performs administrative services related to mass-marketed property and casualty insurance;
- An employer or association engaged in the administration or operation of a program of employee benefits for the employer's or association's own employees;
- Employees of insurers or organizations engaging in the inspection, rating or classification of risks, or in the supervision of the training of insurance producers and who are not individually engaged in the sale of insurance;

- A person whose activities are limited to advertising without the intent to solicit insurance;
- A nonresident who sells, solicits or negotiates a contract of insurance for commercial property and casualty risks to an insured with risks located in more than one state insured under that contract; or
- A salaried full-time employee who counsels or advises his or her employer relative to the insurance interests of the employer or subsidiaries.

AGENT APPOINTMENT

A licensee may not act as an agent unless he or she has been appointed by a designated insurer who is authorized to engage in business in Texas. When an insurer terminates an agent's appointment, it must immediately file with the Commissioner a statement of the facts related to the termination and the date and cause.

If a licensed local recording agent with no appointment from an insurance company refers an application of insurance to a local recording agent who has an appointment with that company, the agent who has the appointment may share the commission with the agent who does not have an appointment if the referral results in the issuance of a policy of insurance.



3. TYPES OF LICENSES

The Department of Insurance in this state may issue an insurance license to any of the following qualified individuals or entities.

AGENT/AGENCY

An agent license can be issued to an individual who is appointed by at least one insurance company admitted or authorized to transact insurance in Texas. Note that only **one license of the same type** is permitted for one agent. No agent may hold more than one license of the same type currently in effect.

An agent license may be issued to a corporation or partnership if it has been admitted to transact insurance in this state, and has submitted the application and paid all the required fees. In addition, the following requirements must be met:

- At least one officer of the corporation or one active partner of the partnership is individually licensed separately from the corporation or partnership;
- An officer, director, member, manager, partner, or other person who has the right or ability to control the corporation or partnership has not had a license suspended or revoked or been the subject of any other disciplinary action by a financial or insurance regulator of any state in the United States, or committed an act for which a license may be denied;

- The corporation or partnership has the ability to pay any amount up to $25,000 on a claim or compensation for a negligent act, error, or omission;
- Each location from which the corporation or partnership will engage in business in this state is registered separately with the Department.

NONRESIDENT AGENTS

A nonresident agent is one who resides or is domiciled in a state other than Texas. A nonresident can be licensed as an insurance agent if the Texas licensing requirements are met, as long as the agent's home state gives Texas residents the same privilege (reciprocity). The applicant must hold a license in good standing in his or her resident state.

The Commissioner can enter into **reciprocal agreements** with officials of other states to waive the written examination requirements for applicants who reside in those states, as long as the following conditions are met:

- The other state requires agent licensing applicants to pass a written examination.
- An appropriate official of the other state certifies that the applicant holds a currently valid insurance license in that state, and either passed a written examination or held a license before examinations were required.
- The applicant has no place of business within Texas as an insurance agent.

If the state line runs through a town, agents who live in the adjoining state may be licensed as resident agents in Texas if they maintain their business office in Texas.

COUNSELOR

A life and health insurance counselor is any person who, for a fee or commission, offers to examine a life, accident, or health insurance policy, an annuity, or pure endowment policy, to give a recommendation or information regarding the policy's terms, conditions, benefits, coverage or premiums.

TEMPORARY

The Commissioner may issue a temporary life insurance agent's license, effective for **90 days**, without requiring a written examination to applicants who complete a 40 hour training course before applying for the license or within 14 days after applying for the license, to the following people:

- An applicant who has submitted the application and fee and wants to collect premiums on industrial life insurance contracts during the period of the temporary license; or
- Anyone who an insurer is considering for appointment as a full-time agent, as soon as the department receives the application and a certificate signed by the insurer's authorized representative requesting a temporary license for the applicant being considered.

Temporary licenses are **not renewable** and cannot be issued more than **once** in any **6-month period** to the same applicant.

Temporary licensees cannot sell insurance that replaces an existing individual life insurance policy or annuity contract that is in force. Limitation does not apply to temporary agents who write accident and health policies.

4. Maintenance and Duration

The Commissioner will issue an initial license after the applicant passes a written examination. If the license is denied, the Commissioner must notify the applicant and insurer, in writing, that the license will not be issued.

Expiration and Renewal

An agent's license must be renewed every **2 years** on the licensee's birthday, either on even-numbered or odd-numbered years depending on when the license was issued, and will continue in effect until refused, revoked or suspended by the Commissioner.

The Commissioner will send an agent whose license is about to expire notice of such expiration at least **30 days** before that date.

If an agent allowed his or her license to expire, the following reinstatement rules apply:

- If expired for **no more than 90 days:** the license may be renewed by filing a renewal application, paying the renewal fee, and paying an additional fee (equal one-half of the renewal fee);
- If expired for **more than 90 days but less than 1 year:** the licensee may obtain a new license by filing a new application with the Department, paying the license fee and an additional fee equal to one-half of the license fee. A license examination is not required.
- If expired for **more than 1 year:** the license cannot be renewed. The person must go through a complete licensing process as required by the State for any new applicants. In addition, the agent may not use any continuing education credits that were obtained before the new license is granted to satisfy any certification course or continuing education course requirements for the new license.

Continuing Education

Continuing education (CE) rules are established to protect the public by maintaining high standards of professional competence in the insurance industry, and to maintain and improve the insurance skills and knowledge of licensed producers.

Licensees must complete **24 hours** of continuing education every renewal period before the expiration date of the license, unless otherwise exempt. At least 2 of CE hours must cover **ethics**. If a licensee holds more than one license, the licensee is only required to complete 24 hours of CE for all licenses during the license period.

All CE hours must be completed during the reporting period; licensees are not allowed to carry over excess hours to the next reporting period.

If a licensee does not complete the 24 hours of CE before the expiration date of the license, the licensee will have 90 days to complete the deficient number of hours and pay a fine of $50 per deficient hour. If these two conditions are not met within 90 days of the license expiring, the license will be inactivated, and the licensee will have to apply for a new license.

The continuing education requirements **do not apply in the following cases:**

- Agents who have been continuously licensed for 20 years or more as of December 31, 2002, are exempt from continuing education requirements. Agents whose renewal date is after 12/31/2002 could still be exempt from CE requirements as long as they have been licensed by the Texas Department of Insurance for over 20 years without gaps in licensure longer than 90 days.
- Agents who are licensed solely to receive residual or renewal commissions;
- Nonresident agents, who are subject to continuing education requirements in their home state if their home state exercises reciprocity with the continuing education requirements of Texas;
- Agents who qualify for an exemption because of illness, medical disability or circumstances beyond their control; and
- Retired agents.

At least **50%** of all required continuing education hours must be completed in a **classroom** or a **classroom equivalent** setting approved by the Department. The Department may accept continuing education hours completed in other professions.

Producers must maintain records of completion of continuing education courses for **4 years** from the date of the course completion. Those records must be readily available for the Department's investigation or audit.

To be certified as a continuing education course, the course must be designed to enhance the student's knowledge, understanding, and professional competence regarding specified subjects for an insurance product. There are also specific requirements for **product certification courses**, such as Medicare-related or long-term care product certification.

Producers who transact Medicare and Medicare Supplement insurance must complete an 8-hour Medicare-related product certification course as part of their CE requirement. Approved Medicare-related product certification courses must cover, at a minimum, the following topics related to Medicare products:

- Types, features and availability of Medicare products;
- State and federal laws;
- Prohibited sales practices;
- Sales suitability rules; and
- Fraudulent and unfair trade practices.

Resident agents who intend to sell, solicit, or negotiate **annuity** contracts must complete a **4-hour** training relating to annuities prior to any transactions. Producers who continue to sell annuities must complete 4 hours of annuity related continuing education annually. These hours may be used to satisfy producer's general continuing education requirements.

Notifying the Department of Certain Information

An individual licensed as an agent must notify the Texas Department of Insurance (TDI) on a **monthly** basis of any of the following:

- A change of the mailing address;
- A felony conviction; or
- An administrative action taken against the licensee by a financial or insurance regulator of Texas, another state, or the United States.

A corporation or partnership licensed as an agent must file biographical information with the TDI for:

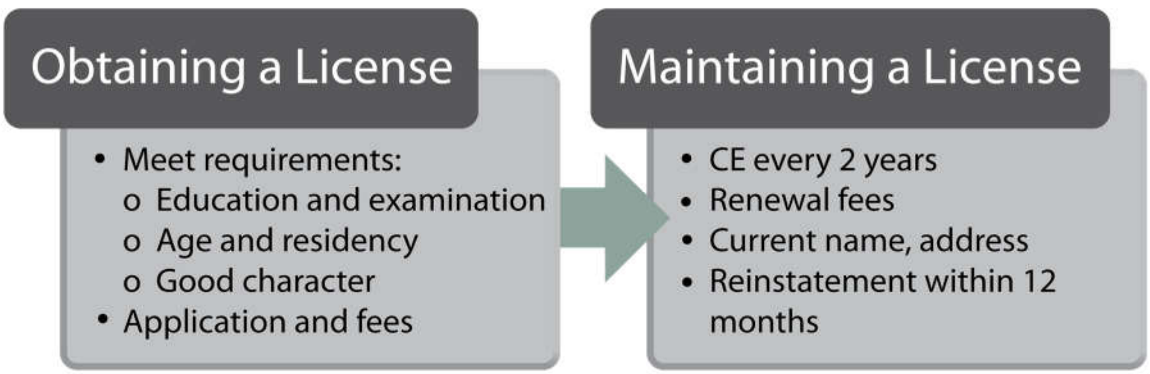
- Each executive officer, director, or unlicensed partner who administers the entity's operations;
- Each shareholder who is in control of the corporation or partner who has the right or ability to control the partnership; and
- If the corporation or partnership is owned, in whole or in part, by another entity, each individual who is in control of the parent entity.

A corporation or partnership must notify the Department no later than **30 days** after the date of:

- A felony conviction of a licensed agent; and
- The addition or removal of an officer, director, partner, member, or manager.

RECORDS MAINTENANCE

An agent must maintain all insurance records (including all records relating to customer complaints) separate from the records of any other business of the agent.



5. DISCIPLINARY ACTIONS

DENIAL OF LICENSE

The Commissioner may discipline a license holder or deny an application to anyone who has done any of the following:

- Willfully violated any provision of the Texas Insurance Code;
- Intentionally made a material misstatement in the licensing application;
- Obtained, or attempted to obtain, the license by fraud or misrepresentation;
- Misappropriated or converted to personal use money belonging to an insurer, insured or beneficiary;
- Been guilty of fraudulent or dishonest practices;
- Materially misrepresented the terms and conditions of life insurance policies or contracts;
- Made or issued any statement misrepresenting or making incomplete comparisons regarding the terms of an insurance or annuity contract in an attempt to induce the owner to forfeit or surrender the contract and replace it with another (also called twisting); or
- Been convicted of a felony.

SURRENDER OF LICENSE

The **surrender of an agent's license** to the insurance department will not negate any offense committed before the surrender's effective date. Surrendering the license will not keep the agent from being penalized.

SUSPENSION, REVOCATION OR REFUSAL TO RENEW

The Commissioner will suspend or revoke an existing license, or deny a new license for any of the following reasons:

- Willful violations of state insurance laws;
- Intentional material misstatements in the license application;
- Attempting to obtain a license by fraud or misrepresentation;
- Felony conviction;
- Rebates of insurance premiums.

No one whose license has been revoked can apply for another license in Texas for **5 years.**

If an individual agent or a corporate official of an insurer has been convicted of a felony involving moral turpitude or of a breach of fiduciary duty, the individual's license or the company's application for a certificate of authority may be *denied* or *revoked.* If the official is terminated, the company's certificate of authority may not be revoked. A petition for issuance or reinstatement of a certificate of authority may be made at any time after the convicted corporate official is no longer with the company.

The petition for reinstatement or issuance should be filed with the associate commissioner, and must include the following information:

- The date of final conviction and/or the date the sentence or probation terminated; and
- The reasons why the petitioner believes the license should be issued or reinstated.

The office of the associate commissioner may order an investigation in the matter, and may grant the petition if the petitioner demonstrates that it would be in the best public interest and that justice would be served if the license was issued or reinstated.

INTENT TO ACTIVELY ENGAGE IN BUSINESS OF INSURANCE FOR GENERAL PUBLIC

Insurance licenses are issued with the intent that the licensee will engage in the business of insurance with members of the general public, and that the license will not be used primarily to earn commissions on personal business, from the licensee's immediate family or close associates — known as *controlled business*.

In the state of Texas, at least **25%** of a licensee's total volume of premiums in a calendar year must be from business other than controlled business (from persons other than the applicant and from property other than that on which the applicant controls the placing of insurance through ownership, mortgage, sale, family relationship, or employment).

6. Summary of Producer Regulations

LICENSING REQUIREMENTS	
18	Minimum required age for licensing
12 months	Results of the licensing examination are valid
90 days	Maximum duration of temporary licenses
6 months	No more than one temporary license issued per person
2 years	Duration of reporting period
24 hours	Continuing education to be completed during each reporting period
2 hours	Minimum requirement for ethics training
1 year	Maximum period for license reinstatement after lapse without retaking examination
5 years	After license revocation or denial before another license application can be filed

D. Marketing Practices

1. Unfair/Prohibited Trade Practices

Insurers and insurance producers may not engage in any trade practice that is defined as, or determined to be, an unfair method of competition or an unfair or deceptive act or practice in the business of insurance.

It is considered an unfair trade practice to knowingly commit an unfair method of competition or to engage in such actions with enough frequency that the commission of unfair marketing practices indicates a general business practice.

If, after a hearing, the Department of Insurance determines that a producer or an insurer has committed an unfair trade or competition practice, the Department may issue an order requiring the person to cease and desist from engaging in the method of competition, act, or practice, and/or impose penalties for violation of insurance laws.

Misrepresentations

It is illegal to issue, publish, or circulate any illustration or sales material that is false, misleading, or deceptive as to policy benefits or terms, the payment of dividends, etc. This also refers to oral statements. Committing this illegal act is called **misrepresentation**.

It is an unfair method of competition or an unfair or deceptive act or practice in the business of insurance to **misrepresent** an insurance policy by:

- Making an untrue statement of material fact;
- Failing to state a material fact necessary to make other statements made not misleading;
- Making a statement in a manner that would mislead a reasonably prudent person to a false conclusion of a material fact;
- Making a material misstatement of law; or
- Failing to disclose a matter as required by law.

FALSE ADVERTISING

Advertising covers a wide scope of communication, from publishing an ad in a newspaper or magazine, to broadcasting a commercial on television or the Internet. Advertisements cannot include any untrue, deceptive, or misleading statements that apply to the business of insurance or anyone who conducts it. The violation of this rule is called **false advertising.**

It is prohibited to advertise or circulate any materials that are untrue, deceptive, or misleading. False or deceptive advertising specifically includes **misrepresenting** any of the following:

- Terms, benefits, conditions, or advantages of any insurance policy;
- Any dividends to be received from the policy, or previously paid out;
- Financial condition of any person or the insurance company; or
- The true purpose of an assignment or loan against a policy.

Representing an insurance policy as a share of stock, or using names or titles that may misrepresent the true nature of a policy also will be considered false advertising. In addition, a person or an entity cannot use a name that deceptively suggests it is an insurer.

DEFAMATION OF INSURER

Defamation occurs when an oral or written statement is made that is intended to injure a person engaged in the insurance business. This also applies to statements that are **maliciously critical** of the *financial condition* of any person or a company.

REBATING

Rebating is defined as any inducement offered to the insured in the sale of insurance products that is not specified in the policy. Both the offer and acceptance of a rebate are illegal. Rebates may include, but are not limited to, the following:

- Rebates of premiums payable on the policy;
- Special favors or services;
- Advantages in the dividends or other benefits; and
- Stocks, bonds, securities, and their dividends or profits.

The state regulations do not prohibit agents from giving or providing promotional materials, educational items, articles of merchandise, or traditional courtesy commonly extended to consumers valued at **$25 or less**.

COMMINGLING

Because agents/producers handle the funds of the insured and the insurer, they have **fiduciary responsibility**. A *fiduciary* is someone in a position of trust. Insurance producers are prohibited from commingling premiums collected from the applicants with their own personal funds.

Note, however, that life insurance policy proceeds received by a trustee named as the beneficiary in the policy may be commingled with any other assets properly coming into the trust.

BOYCOTT, COERCION AND INTIMIDATION

It is illegal to be involved in any activity of **boycott, coercion, or intimidation** that is intended to restrict fair trade or to create a monopoly. This would include unfair behavior that influences not only clients, but competing agents and brokers.

Coercion is to require, as a condition to a loan, that the applicant purchase insurance from a specific insurer.

UNFAIR DISCRIMINATION

Discrimination in rates, premiums, or policy benefits for persons within the **same class** or with the same life expectancy is illegal. No discrimination may be made on the basis of an individual's marital status, race, national origin, gender identity, sexual orientation, creed, or ancestry unless the distinction is made for a business purpose or required by law.

While not a complete list of acts that may be considered unfair discrimination, the following are practices in life and health insurance which constitute unfair discrimination between individuals of the same class:

- Discriminating solely because of a physical or mental impairment;
- Discrimination due to blindness or partial blindness; or
- Investigating as part of the underwriting process a proposed insured's sexual orientation.

FRAUD

Fraud is the intentional misrepresentation or intentional concealment of a material fact used to induce another party to make or refrain from making a contract, or to deceive or cheat a party. Fraud is grounds for voiding an insurance contract.

The Texas Department of Insurance has an Insurance Fraud Unit to enforce laws relating to fraudulent insurance acts. A fraudulent insurance act is any illegal act that has been:

- Committed in the business of insurance;
- Committed as a part of or in support of an insurance transaction;
- A part of an attempt to defraud an insurer.

Through the Insurance Fraud Unit, the Commissioner has a duty to develop fraud prevention educational programs and disseminate materials necessary to educate the public effectively regarding antifraud programs. The Insurance Fraud Unit must report annually to the Commissioner in writing regarding the number of cases completed by the unit, and recommendations for regulatory and statutory responses regarding fraudulent activities encountered by the unit.

If the Commissioner has reason to believe that a person has engaged, is engaging in or is about to engage in an act that may constitute a fraudulent insurance act or insurance fraud, the Commissioner may make any investigation necessary to determine whether the act occurred or to aid the enforcement of the insurance fraud laws. If the Commissioner believes a fraudulent insurance act has occurred, he or she will take the appropriate disciplinary measures as well as report the information to the proper law enforcement authorities.

If a person suspects that a fraudulent insurance act has been or is about to be committed in this state, the person must **report** the information in writing to the Insurance Fraud Unit of the Department within **30 days**. A report made to the insurance fraud unit constitutes notice to each other authorized governmental agency.

A person cannot be liable in a civil action, including an action for libel or slander, and a civil action may not be brought against the person for furnishing information relating to a suspected, anticipated, or completed fraudulent insurance act if the information is provided to any of the following:

- An authorized governmental agency or the department;
- A law enforcement officer or an agent or employee of the officer;
- The National Association of Insurance Commissioners;
- A state or federal governmental agency established to detect and prevent fraudulent insurance acts; or
- A special investigative unit of an insurer.

2. Commission Sharing

Both insurers and agents must understand the rules dealing with payment of commissions. An insurer or licensed insurance agent doing business in Texas must not pay commissions to any person or corporation for services as an insurance agent within Texas unless that person holds a valid agent's license. A temporary license holder cannot receive commissions from a sale made to a family member or an employment or business associate. A person or corporation that is not a licensed insurance agent cannot accept any such commissions or other valuable consideration.

An agent can charge a client a reasonable fee for services rendered to a client, such as follows:

- Special delivery or postal charges;
- Electronic mail costs;
- Telephone transmission costs;
- Similar costs that the agent incurs on behalf of the client.

If the agent does charge fees for these services, he/she must first inform the client and obtain the client’s written consent for each fee.

An unlicensed person may refer a customer or potential customer to an agent. This is not considered acting as an agent, and is legal as long as the unlicensed individual does not discuss specific insurance policy terms or conditions with the customer.

It is **illegal** for an insurer or agent to pay an unlicensed person for performing the duties of an agent. This includes a rebate of premiums payable, a commission, employment, a contract for service, or any other inducement that is not specified in the insurance policy. This doesn't apply to deferred commissions or compensation if the unlicensed person formerly held an agent's license.

If a licensed local recording agent with no appointment from an insurance company refers an application of insurance to a local recording agent who has an appointment with that company, the agent who has the appointment may share the commission with the agent who does not have an appointment if the referral results in the issuance of a policy of insurance.

3. Claims Methods and Practices

The following acts, omissions, or practices are defined as unfair and deceptive claim settlement practices when knowingly committed or performed with such frequency as to indicate a general business practice, and are prohibited:

- Misrepresenting to insureds pertinent facts or policy provisions relating to coverage at issue;
- Failing to acknowledge and act reasonably promptly upon communications with respect to an insurance claim;
- Failing to adopt and implement reasonable standards for prompt investigation and processing of insured's claims;
- Failing to affirm or deny coverage of claims within a reasonable time after proof of loss statements are completed and submitted by insureds;
- Not attempting in good faith to effect prompt, fair and equitable settlements of claims on which liability has become reasonably clear;
- Refusing or delaying a settlement solely because there is other insurance available to partially or entirely satisfy the claim loss; the claimant who has a right to recover from more than one insurer has the right to choose the coverage from which to recover and the order in which payment is to be made;
- Compelling insureds to initiate suits to recover amounts due under an insurance policy by offering substantially less than the amount ultimately recovered in those suits.

The Texas Department of Insurance (TDI) may require an insurer to file periodic reports based on complaints of unfair settlement practices. The reports must contain the following information:

- The total number of claims from the past 3 years, and information on how or if they were settled;
- The total number of complaints, their classification by line of insurance, the nature of each complaint, the disposition of these complaints, and the time it took to process each complaint.

Failure to maintain records of the complaints above is an unfair claim settlement practice.

Prompt Payment of Claims

Claims must be settled promptly. No later than the **15th business day** following receipt of a notice of a claim, the insurer must do the following:

- Acknowledge receipt of the claim;
- Begin an investigation of the claim; and
- Request all statements, forms and items that the insurer believes will be required from the claimant.

Surplus lines insurers have until the 30th day following receipt of a notice of a claim to perform the above requirements.

No later than the 15th business day after the insurer receives all requested items, forms and statements, the insurer must notify the claimant in writing of its acceptance or rejection of the claim. If the insurer suspects that arson is involved, the insurer has until the 30th day to notify the claimant of its acceptance or rejection.

If the insurer rejects a claim, the notice to the claimant must contain the reasons for the rejection. If the insurer needs more time for a claim decision, the insurer must give the claimant the reasons for the delay and must accept or reject a claim no later than the 45th day after the insurer notifies the claimant of a delay.

Once a claim is approved, the insurer must pay the claim within **5 business days** after the insurer notifying the claimant that a claim will be paid. Surplus lines insurers have until the 20th business day to pay the claim under these circumstances. Insurers who delay payments may be subject to additional damage payments.

For good cause shown, insurers may have additional time to settle related claims.

E. Guaranty Association

The Texas Life and Health Insurance Guaranty Association was created to protect policyowners, insureds, beneficiaries, and anyone entitled to payment under an insurance policy from the incompetence and insolvency of insurers. The Association is a nonprofit legal entity subject to the applicable provisions of the state Insurance Code and laws and the immediate supervision of the Commissioner. The Association is funded by its members through assessment, and **all authorized insurers** must be members of the Association. The association will pay covered claims up to certain limits set by state law.

It is considered an **unfair trade practice to advertise** protection by the Life, and Health Insurance Guaranty Association when selling any product that is covered by the Association.

F. Chapter Recap

Make sure you review the following key terms before taking practice tests and the state exam.

Basic Terms	Agent Agent appointment Commissions Nonresident agent Temporary license
Licensing	Certificate of Authority Continuing education Expiration Renewal Revocation of license Surrender of license
State and Federal Regulations	Department of Insurance Cease and desist order Commissioner Examination of records Hearings

Unfair Trade Practices	Boycott Coercion Defamation Fraud Intimidation Misrepresentation Rebating Unfair discrimination Unlawful inducement

This chapter focused on state-specific regulations for insurers and producers. Let's first recap some of the important requirements and processes, and then review a list of important numbers, days and dates.

LICENSING REQUIREMENTS	
Licensing Process	• Pass examination • Submit application and fees
Types of Licenses	• Individuals: resident and nonresident • Temporary license - valid for 90 days; issued to maintain the existing business

Maintenance and Duration	• Must be renewed every 2 years
	• Can be reinstated within a short period of time after lapse
	• Continuing education - must be completed every reporting period
	• Disciplinary actions:
	  o Suspension, revocation or refusal to renew license
	  o Cease and desist order
	  o Monetary penalties

STATE AND FEDERAL REGULATIONS	
Commissioner of Insurance	• Appointed by the Governor for 2 years • Regulates the internal affairs of the Department of Insurance • Does not write laws • Examines all authorized insurers
Agent Regulation	• Only one license of the same type is allowed per agent • Must be licensed in the line of authority for which the agent transacts insurance • Avoid unfair trade practices
Company Regulation	• Certificate of Authority • Domestic/foreign/alien - location of incorporation • Ownership: stock or mutual • Avoid unfair trade practice or unfair claims settlements

G. Chapter Quiz - Texas Statutes and Rules Common to Life and Health Insurance

1. A temporary license is normally valid for

A. 1 year.
B. 6 months.
C. 90 days.
D. 30 days.

2. A life agent's license must be renewed

A. Every year on January 1.
B. Every year on the anniversary date of issuance.
C. Every 2 years on the anniversary date of issuance.
D. Only when the agent has not been active.

3. In an insurance transaction, which of the following does a licensed agent represent?

A. Insurer
B. Insured
C. Insurance Department
D. Commissioner

4. An agent who offers a cash reward to a prospect for buying a policy is guilty of

A. Misrepresentation.
B. Twisting.
C. Rebating.
D. Coercion and intimidation.

5. An insurer who deliberately makes a malicious statement about another insurance company is guilty of an illegal trade practice called

A. Discrimination.
B. Defamation.
C. Misrepresentation.
D. False advertising.

6. Who is considered a nonresident agent?

A. An agent who is not a U.S. citizen.
B. An agent whose license has been revoked.
C. An agent who does not earn commission in this state.
D. An agent who resides in another state, but is licensed to write insurance in this state.

7. The Commissioner of Insurance issues a Cease and Desist Order and immediately receives a request for the charges to be reviewed in a hearing. Within how many days must the hearing be held?

A. 3 days
B. 10 days
C. 14 days
D. 30 days

8. All of the following would be considered an insurance transaction EXCEPT

A. Soliciting a policy.
B. Advising a policyowner regarding a claim.
C. Negotiating coverage.
D. Obtaining an insurance license.

9. The Commissioner of Insurance is responsible for all of the following actions EXCEPT

A. Issuing Certificates of Authority.
B. Enforcing the Insurance Code.
C. Setting premium rates.
D. Issuing cease and desist orders.

10. Which of the following persons is required to hold a producer license?

A. A director of the insurer who administers employee benefits
B. A salaried employee who creates insurance advertisements
C. A nonresident agent who negotiates insurance contracts
D. An agent's administrative assistant who takes messages related to claims

11. What is the minimum required number of continuing education credits in ethics every licensing period?

A. 1 hour
B. 2 hours
C. 3 hours
D. 5 hours

12. What is the main purpose of requiring licenses for persons who transact insurance?

A. To generate income for the Department of Insurance
B. To be able to collect commissions
C. To protect insurance companies from incompetent producers
D. To protect the general public

13. Which of the following is NOT an example of a company's location of incorporation?

A. Authorized
B. Domestic
C. Foreign
D. Alien

14. Agents whose license has been revoked will not be able to receive another license in Texas for at least

A. 6 months.
B. 1 year.
C. 2 years.
D. 5 years.

15. How often must producers renew their licenses?

A. Annually
B. Every 2 years
C. Every 3 years
D. Licenses do not need to be renewed; they are perpetual.

Answers to the quiz may be found in Appendix A.

FLASHBACK

Test your retention of the new concepts you learned. **Flashback** to the beginning of the chapter to review the **Snapshots** before moving forward.

VI

TEXAS STATUTES AND RULES PERTINENT TO LIFE INSURANCE ONLY

VI. Texas Statutes and Rules Pertinent to Life Insurance Only

INTRO

This section will explain some of the major regulations that apply exclusively to life insurance in this state. By the end of this section, you should be able to explain the basic laws that apply to different types of life insurance products.

SNAPSHOTS

1. What does *insurance solicitation* mean?
2. Who is responsible for all written and distributed insurance advertisements?
3. How long is the incontestability period in life insurance policies issued in this state?
4. What are the minimum required nonforfeiture options in life insurance policies issued in this state?
5. Who is the owner and who is the beneficiary of a credit life policy?
6. What is the limit on the amount of credit life insurance on a debtor?
7. What are the steps a producer must complete when replacing an existing policy?

EXAM BREAKDOWN

See where to spend your valuable study time! Check out the **Exam Breakdown** at the beginning for chapter percentages.

TERMS TO KNOW

Claimant — a person who submits a claim for payment of benefits
Disclosure — revealed information to help someone make an intelligent and education decision
Dividend — a payment made by a policy (distribution of profits or return of unused funds)
Lapse — policy termination due to nonpayment of premium
Nonforfeiture values — benefits in a life insurance policy that the policyowner cannot lose
Nonguaranteed elements — policy components that are not guaranteed in the contract or that may fluctuate (e.g. dividends, interest)
Policy proceeds — in life insurance, the death benefit
Rescind — remove or cancel (e.g. void a contract)
Testimonials — statements or endorsements made by clients based on their experience with products or services

A. MARKETING AND SOLICITATIONS

The process of issuing a life insurance policy begins with solicitation. In simplest terms, *solicitation of insurance* means an attempt to persuade a person to buy an insurance policy, and it can be done orally or in writing. This includes providing information about available products, describing the policy benefits, making recommendations about a specific type of policy, and trying to secure a contract between the applicant and the insurance company.

Any sales presentations used by insurers or their agents in communication with public must be accurate and complete.

1. ADVERTISEMENTS

First and foremost, **advertising must be accurate and not misrepresent the facts**. Advertising rules apply to any insurance advertisement intended for presentation, distribution, dissemination or other advertising use when used or made either directly or indirectly by or on behalf of the insurance company.

Every insurance company must establish and maintain a system of control over the content, form, and method of dissemination of all advertising of its policies. The **insurer** whose policies are advertised is **responsible for all its advertisements**, regardless of who wrote, created, presented, or distributed them.

Duty of insurers: insurers marketing policies in Texas must maintain a system of control over the content, form, and method of dissemination of all advertisements on their policies. Each insurer is responsible for all advertisements prepared and/or approved by the insurer. No insurer may avoid responsibility for advertisements by directing or authorizing anyone else to prepare or approve them.

Duty of agents: before using an advertisement, an agent must file its contents with the home office of the insurer, and receive a written approval.

Specific Insurance Code regulations for advertisements of life insurance policies in this state include, but are not limited to, the following:

- May not make any unfair or incomplete comparisons with other policies, rates, benefits or dividends;
- Must use language that can be understood by general public;
- Must identify the actual insurer before using trade names, insurance designations, or names of parent;
- No combination of words or symbols similar to those of state or federal government agencies may be used if they could imply that the solicitation is connected with a government agency;
- May not contain false statements regarding claims payment, imply that claim settlements will be liberal or generous or special treatment will be provided beyond policy terms;
- Testimonials must be genuine, accurately reproduced and represent the author's current opinion. If the person is compensated, the testimonial must include "Paid Endorsement."

2. ILLUSTRATIONS

The term ***illustration*** means a presentation or depiction that includes nonguaranteed elements of a life insurance policy over a period of years.

GENERAL RULES

An illustration used in the sale of a life insurance policy must contain the following basic information:

- Name of insurer;
- Name and business address of producer or insurer's authorized representative, if any;
- Name, age, and sex of proposed insured, except when a composite illustration is permitted under this regulation;
- Underwriting or rating classification upon which the illustration is based;
- Generic name of policy, the company product name (if different), and form number;
- Initial death benefit;
- Dividend option election or application of nonguaranteed elements, if applicable
- Illustration date;
- A prominent label stating "Life Insurance Illustration."

REGULATION OF ILLUSTRATIONS

The purpose of the life insurance illustrations regulation is to establish standards for formats, content and disclosure of illustrations that will protect consumers and foster consumer education. The goals of this regulation are to ensure that illustrations do not mislead purchasers of life insurance and to make illustrations more understandable. *For example,* insurers are required to eliminate the use of footnotes and caveats as much as possible, and define terms used in the illustration in language that would be understood by a typical person within the segment of the public to which the illustration is directed.

Illustrations must distinguish between guaranteed and projected amounts, and clearly disclose the following information:

- **Not Part of Contract** — an illustration must clearly state that it is not a part of the insurance contract.
- **Values not Guaranteed** — those values that are not guaranteed must be identified as such.

Agents may only use the illustrations of an insurer that have been approved, and may not change them in any way.

PROHIBITED PRACTICES

When using an illustration in the sale of a life insurance policy, an insurer or its producers **may not:**

- Represent the policy as anything other than a life insurance policy;
- Describe nonguaranteed elements in a manner that could be misleading;
- Use an illustration that depicts policy's performance as being more favorable than it really is;
- Provide an incomplete illustration;
- Claim that premium payments will not be required for each year of the policy in order to maintain the illustrated death benefits, unless that is the fact;
- Use the term "vanish" or "vanishing premium," or a similar term that implies the policy becomes paid up;
- Use an illustration that is not self-supporting.

If an interest rate used to determine the illustrated nonguaranteed elements is shown, it may not be greater than the earned interest rate underlying the disciplined current scale.

3. Life Insurance Policy Cost Comparison Methods

To help consumers make educated decisions on purchasing life insurance, the industry developed specific methods and indexes that measure and compare the actual policy costs. These comparisons are usually included in policy illustrations. Traditional methods of comparing costs are interest-adjusted net cost method and comparative interest rate method.

Interest-Adjusted Net Cost Method

Interest-adjusted net cost method considers the *time value of money* (or investment return on the insurance premium had it been invested elsewhere) by applying an interest adjustment to yearly premiums and dividends. This means that each year premiums and dividends are figured, interest is taken into consideration. Two versions of the interest-adjusted method are the surrender cost index and the net payment cost index.

Comparative Interest Rate Method

The comparative interest rate (CIR) is the rate of return that must be earned on a "side fund" in a *buy term invest the difference plan* so that the value of the side fund will be equal to the surrender value of the higher premium policy at a designated point in time.

B. Policy Provisions

You have already learned about life insurance policies and provisions, clauses, and options that apply to most policies. Here is a list of standard provisions adopted by this state that must be included in life insurance policies issued in this state:

- The policy, a copy of the application, and any attached riders make up the *entire contract.*
- All statements of the insured are deemed representations and not warranties.
- Life insurance policies (individual and group) are *incontestable* after the policy has been in force for a period of **2 years**.
- In the case of a *misstatement of an insured age,* the policy will pay benefits based on what the premiums paid would have purchased at the insured's correct age. This provision allows the insurer to make the change even though the error is discovered beyond the incontestability period. (If the misstatement of age causes an insurer to continue coverage beyond a maximum age stated in the policy, the insurer's only obligation is to return any premiums received after the insured reached the maximum age.)
- A life insurance policy that has cash value must have a provision for the policyowner to *borrow* from those values. (Any unpaid loans at the time of the insured's death will be deducted from the death benefit paid to the beneficiary.)
- Any life insurance policy that has cash value must have a *nonforfeiture* provision.
- A policyowner may request *reinstatement* of a lapsed policy within three years of such lapse by paying the back premiums, with interest, and proving insurability.
- Life insurance policies require that the initial *premium be paid in advance* to effect coverage.
- *Settlement of a death benefit* must not be for less than the face amount of the policy, less any indebtedness. Upon receipt of a written proof of death and the right of the claimant to the proceeds, the insurer must pay death claims within **2 months.**
- The policyowner may *assign* the policy to another party without consent of the insurer.

Individual life insurance policies issued or delivered in this state must also include the following provisions:

Free Look: If a buyer's guide and disclosure document are not provided to the applicant at or before the time of application, the applicant must be allowed a **free-look period** of at least **15 calendar days** during which the applicant may **return the policy for an unconditional refund without penalty**. A notice included on or attached to the cover page must prominently disclose information regarding the free-look period. The free look-period begins the day the consumer receives the contract.

Grace Period: A consumer must be provided a **grace period** of at least **one month** for the payment of each premium during which the policy remains in force. If the insured dies during the grace period, the overdue premium will be deducted from any settlement made under the policy.

Policy Loans: A life insurance policy must allow the policyowner to take out a **policy loan** from the policy's cash value as long as:

- The policy is in force;
- The premiums have been paid for at least 3 full years;
- And the policy is properly assigned.

Failure to repay the policy loan or interest on the loan will not void the policy until the total amount owed under the loans equals or exceeds the policy's cash value.

Note that the policy loan provision applies only to policies that provide cash values or nonforfeiture values (not term policies or pure endowment contracts).

1. Viatical Settlement Disclosures

A viatical settlement provider must disclose the following information to the viator prior to the execution of the viatical settlement contract:

- How viatical settlements operate;
- Possible alternatives to viatical settlements for persons with catastrophic or life-threatening illnesses, including, but not limited to, accelerated benefits offered by the issuer of the life insurance policy and loans secured by the life insurance policy;
- The fact that the viatical settlement could be subject to the claims of creditors;
- The fact that receipt of proceeds from a viatical settlement may adversely affect the recipient's eligibility for Medicaid or other government benefits or entitlements, and that advice should be obtained from the appropriate agencies;
- Tax consequences that may result from entering into a viatical settlement;
- Consequences of interruption of assistance as provided by medical or public assistance programs;
- The viator's right to rescind a viatical settlement within 15 days of receiving the viatical settlement proceeds; and
- The identity of any person who will receive any fee or compensation from the viatical settlement company with respect to the viatical settlement and the amount and terms of such compensation.

2. Prohibited Provisions

Certain Limitations Periods: A life insurance policy may not include a provision that limits the time during which a lawsuit may be filed to a period of less than **2 years** after the cause of action.

Retroactive Issuance, Exchange or Conversion: A life insurance policy may not contain a provision under which the policy is issued on a date more than **6 months** before the date of the application **(backdating)** if it causes the insured to rate at an age that is younger than the insured's age on the date of the application (for the purposes of this subsection, the age of the insured on the date of the application is the age the insured was/will be on the birthday nearest to the date of the application).

If the policyholder consents, an issuer can exchange or convert a policy into another plan as of a date not earlier than the effective date of the original policy. If an exchange or conversion is made and the newly written policy is issued as of a date earlier than the date of the application for exchange or conversion, the amount of insurance or annuity under the new policy may not exceed the greater of the amount of the original policy or the amount that the premium paid for the original policy would have purchased for an individual the age of the insured on the effective date of the original policy.

Settlement upon Maturity: The life insurance policy may not contain a provision for a settlement at maturity that is **less than the face amount** of the policy plus the amount of any dividend additions to the policy minus any debt owed to the company and any premium that may be deducted from the settlement. However, the policy may provide for a settlement below the face amount of the policy if the insured dies by suicide, or death is caused by a hazardous occupation or as a result of aviation activities under certain conditions specified in the policy.

C. Nonforfeiture Law

Nonforfeiture benefits are built into the policy and provide a guarantee that they **cannot be forfeited** (lost) y the policyowner. These guarantees are required by state law to be included in the policy.

There are state regulations that apply specifically to nonforfeiture benefits in individual and group life insurance policies and annuities that provide long-term care insurance. According to the state regulations, the nonforfeiture provision must be clearly captioned in the policy, and must provide for a benefit available in the event of a default in the payment of the premium. All insurers must offer at least one of the following nonforfeiture options:

- Reduced paid-up;
- Extended term; and
- Shortened benefit period.

A life insurance policy must ensure the following:

1. That upon surrender of the policy no later than **60 days** after the due date of a premium payment, the company will **pay a cash surrender value** (instead of a paid-up nonforfeiture benefit) if the premiums have been paid for at least 3 full years for ordinary life insurance policies, or 5 years for industrial life insurance;
2. That a specified paid-up nonforfeiture benefit is effective as specified by the policy unless the eligible person elects a different option within 60 days after the due date of the premium; and
3. That upon surrender of the policy no later than 30 days after the policy anniversary, the company will pay a cash surrender value if the policy is paid up or continued under a paid-up nonforfeiture benefit.

The insured has the right to accept or reject the nonforfeiture benefit. It is the agent's responsibility to provide information to the prospective policyowner to help him or her understand and accurately complete the rejection statement.

Any paid-up nonforfeiture benefit available under the policy on default in the payment of a premium due on a policy anniversary must be such that its present value as of the policy anniversary is at least equal to the cash surrender value available under that policy at that time, or if a cash surrender value is not available under the policy, the value that would have been required if there were no conditions that premium must have been paid for at least a specified period.

Nonforfeiture requirements **do not apply** to the following types of insurance products:

- Reinsurance;
- Group insurance;
- Pure endowment;
- Annuities;
- Most term policies;
- Policies delivered outside of Texas through an agent or other company representative; or
- Any policy that does not provide for cash values or nonforfeiture values.

D. Group Life

A group policy issued in this state must cover **at least 2 employees** on the date of its issue. If the insured employees do not pay any part of the premium, the policy must insure all eligible employees.

The following provisions apply to **termination and conversion** of group life insurance policies issued in this state:

- The eligible individuals who have been covered under a group policy for at least 5 years must apply for an individual policy and pay the first premium to the insurer within 31 days after the date the individual's membership in a group plan terminates.
- The individual policy must be issued without evidence of insurability.
- The insured has the right to select any individual policy offered by the insurer, except for term insurance.
- The amount of the individual policy coverage cannot exceed the lesser of the amount of the prior group coverage, or $2,000.

If the individual insured dies during the conversion period, the insured's beneficiary is entitled to the death benefit, which will be paid by the group policy.

The insured may **assign** all rights and benefits under the policy to any individual, firm, corporation, association, trust, or other legal entity, other than the insured's employer.

Coverage under a group life insurance policy may be extended to the **insured's spouse and eligible children**. A natural or adopted child is eligible if the child is younger than 25 years of age or physically or mentally disabled and under the parents' supervision. Natural or adopted grandchildren are also eligible as long as they are younger than 25 years old.

Upon termination of group life insurance coverage for a spouse because the insured's employment terminates, the insured's eligibility for insurance terminates, or the insured dies, or because the group life insurance policy terminates, the spouse has the same conversion rights as to the group life insurance on the spouse's life as the insured.

1. Group Policy Provisions

Group policies have many of the same policy provisions included in individual insurance such as a 2-year *incontestability period* and a 31-day *grace period*. However, the *Misstatement of Age* provision found in group policies is different from that found in individual policies. In group insurance, if the insured participant misstated his or her age, the insurer will adjust the *premium* and/or the *benefit* to the correct age (in individual insurance only the *benefit* is adjusted).

Participants of group insurance are usually allowed to cover dependents on their policies. **Dependent coverage** usually applies to the insured's spouse and children, but may also include dependent parents or anyone else on which dependency can be proven.

E. Credit Life

Credit insurance is a special type of coverage written to insure the life of the debtor and pay off the balance of a loan in the event of the death of the debtor. Credit life is usually written as **decreasing term insurance**, and it may be written as an individual policy or as a group plan. When written as a group policy, the creditor is the owner of the master policy, and each debtor receives a certificate of insurance.

The creditor is the owner and the beneficiary of the policy although the premiums are generally paid by the borrower (or the debtor). **Credit life insurance cannot pay out more than the balance of the debt**, so that there is no financial incentive for the death of the insured. The creditors may require the debtor to have life insurance; they cannot, however, require that the debtor buys insurance from a specific insurer.

In this state, if a credit life insurance is terminated for all plans in which death benefits are not payable due to a policy exclusion, the insurer will refund any unearned gross premium paid for credit life insurance. If a policy is terminated due to the payout of the death benefit, the premiums paid to the insurer are deemed earned and no refund is required.

F. Replacement

Replacement means any transaction in which new life insurance or a new annuity is purchased and, as a result, the existing life insurance or annuity has been or will be any of the following:

- Lapsed, forfeited, surrendered, or otherwise terminated;
- Reissued with any reduction in cash value;
- Converted to reduced paid-up insurance, continued as extended term insurance or otherwise reduced in value by the use of nonforfeiture benefits or other policy values;
- Amended so as to affect either a reduction in benefits or in the term for which coverage would otherwise remain in force or for which benefits would be paid; or
- Used in a financed purchase.

Replacing insurer is the company that issues the new policy.
Existing insurer is the company whose policy is being replaced.

Duties of the replacing producer:

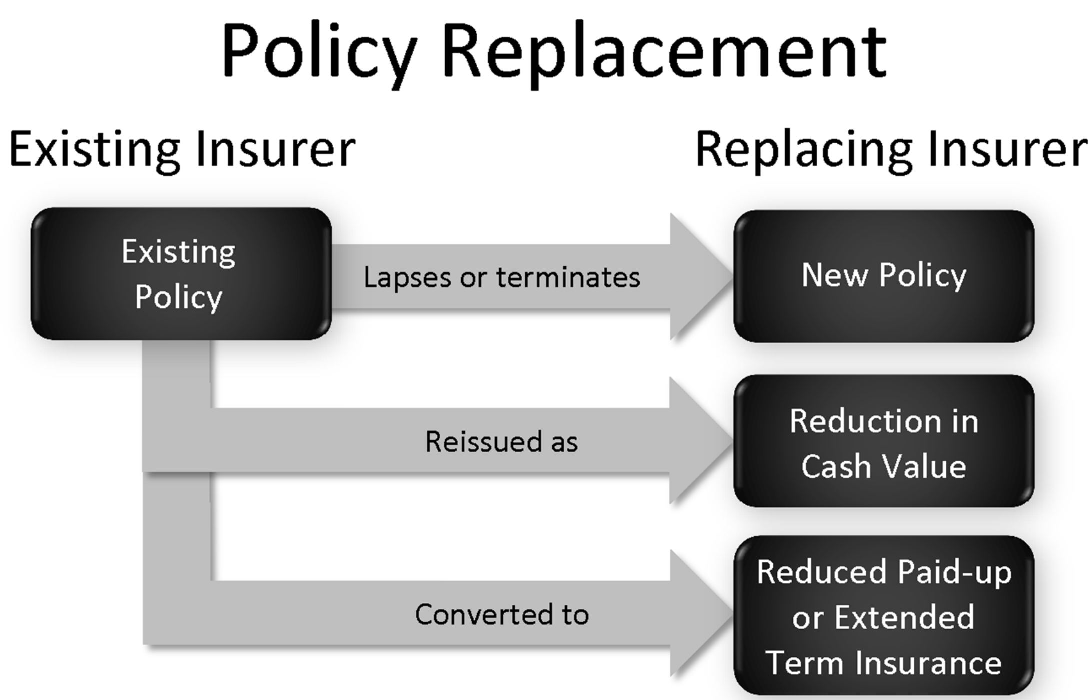
- Present to the applicant a **Notice Regarding Replacement** that is signed by both the applicant and the producer. A copy must be left with the applicant.
- Obtain a list of all existing life insurance and/or annuity policies to be replaced including policy numbers and the names of all companies being replaced.
- Leave the applicant with the original or a copy of written or printed communications used for presentation to the applicant.
- Submit to the replacing insurance company a copy of the replacement notice with the application.

Each producer who initiates the application must submit the following to the insurance company with or as part of each application:

- A statement signed by the applicant as to whether replacement of existing life insurance or annuity is involved in the transaction; and
- A signed statement as to whether the producer knows replacement is or may be involved in the transaction.

Duties of the replacing insurance company:

- Require from the producer a list of the applicant's life insurance or annuity contracts to be replaced and a copy of the replacement notice provided to the applicant; and
- Send each existing insurance company a written communication advising of the proposed replacement within a specified period of time of the date that the application is received in the replacing insurance company's home or regional office. A policy summary or ledger statement containing policy data on the proposed life insurance or annuity must be included.



Exemptions:

The replacement regulation does not apply to the following types of insurance:

- Credit life;
- Group life insurance and group annuities (not direct solicitation);
- An application to the existing insurer that issued the existing policy when a contractual change or conversion privilege is being exercised, or when the existing policy is being replaced by the same insurer;
- Replacement under a binding or conditional receipt issued by the same company;
- Policies used to fund an employee pension or welfare benefit plans that are covered by ERISA;
- New coverage provided under a life insurance policy the cost for which is borne in full by the insured's employer;
- Existing nonconvertible nonrenewable term life insurance policy that expires within 5 years;
- Immediate annuities purchased with proceeds from an existing contract; or
- Structured settlements.

G. Chapter Recap

Make sure you review the following key terms before taking practice tests and the state exam.

Marketing and Solicitation Terms	Advertisement Comparative interest rate Illustrations Interest-adjusted net cost method Solicitation
Policy Provisions	Entire contract Free look Grace period Incontestability Legal action Misstatement of age Nonforfeiture provisions Policy loan Reinstatement Settlements Viatical settlements
Replacement	Existing insurer Notice Regarding Replacement Replacing insurer

This chapter focused on state-specific regulations pertaining to life insurance products. Let's recap some of the important requirements and processes.

MARKETING AND SOLICITATION	
Advertisements	• Accurate and not misleading • Insurers are responsible for all advertisements
Illustrations	• Presentation of nonguaranteed elements • General rule: include information about the insurer, insured, underwriting classifications, policy benefits • Must be clearly labeled "Life Insurance Illustration"
Life Insurance Policy Comparison Methods	• Interest-Adjusted Net Cost method: time value of money • Comparative Interest Rate method: rate of return
POLICY PROVISIONS	
Required Provisions	• *Free-look period* - 15 calendar days • *Grace period* - one month • *Policy loans* - after 3 full years in cash value policies • *Backdating* - 6 months • *Legal action* - within 2 years after loss • *Payment of claims* - within 2 months of the claim *See Policy Provisions, Riders, and Options chapter for review of all provisions*
Nonforfeiture Law	• Guarantees benefits that cannot be forfeited (lost) by the policyowner • 3minimum nonforfeiture options: reduced paid-up, extended term, and shortened benefit period
OTHER LIFE POLICIES AND REGULATIONS	
Group Life	• Termination and conversion rules • Policy provisions: o *Incontestability period* - 2 years o *Grace period* - 31 days o *Misstatement of age* - insurer adjusts premium and benefits
Credit Life	• Creditor is the owner and the beneficiary • Borrower pays the premium
Viatical Settlements	• Third party contracts • Viator receives a *percentage* of the policy's face amount • May be rescinded within 15 days of the payment
REPLACEMENT	
General Rules	• Transaction in which a new policy replaces an existing policy that is: o Lapsed, forfeited, surrendered, or terminated o Reissued with a reduction in cash value o Converted to reduced paid-up insurance • Notice Regarding Replacement (provided by the agent)

Exemptions	• Credit life • Group life and annuities • Existing policy replaced by the same insurer • Existing nonconvertible nonrenewable term policy that expires within 5 years • Immediate annuities

H. CHAPTER QUIZ - TEXAS STATUTES AND RULES PERTINENT TO LIFE INSURANCE ONLY

1. Which of the following is the beneficiary in credit life insurance?

A. Insured
B. Borrower
C. Creditor
D. The insurance company

2. A printer has hired an advertising agency to design and edited advertisement brochures for an insurance company. Once the brochures are printed, who is responsible for the advertisements and their content?

A. The printer
B. The advertising agency
C. The insurance company
D. The Department of Insurance

3. What provision in a life insurance policy extends coverage beyond the premium due date?

A. Automatic premium loan
B. Waiver of premium
C. Free look
D. Grace period

4. According to the limitations of lawsuits provision, how many years does a claimant have to take legal action against the insurer?

A. 1 year
B. 2 years
C. 5 years
D. 7 years

5. What is the term for an insured who enters into a viatical settlement?

A. Viator
B. Third party
C. Viatical broker
D. Viatical beneficiary

6. How long is the grace period in group life policies issued in this state?

A. 15 days
B. 21 days
C. 31 days
D. 90 days

7. In credit life insurance, who is responsible for paying the policy premium?

A. Creditor
B. Borrower
C. Beneficiary
D. Policyowner

8. In an individual life insurance policy, when must the nonforfeiture benefits begin?

A. After the first policy year
B. After 3 policy years
C. At the end of the second policy year
D. At the request of the insured

9. The use of words or symbols that are similar to which of the following entities is prohibited in life insurance advertisement?

A. Federal government
B. NAIC
C. Stock companies
D. Private insurers

10. How many days does a viator have to rescind a viatical settlement after receiving the proceeds?

A. 10 days
B. 15 days
C. 30 days
D. 60 days

11. Which of the following provisions prevents an insurer from denying a claim due to statements made on a life insurance application after the policy has been in force for a period of time?

A. Grace period
B. Representations
C. Legal action
D. Incontestability

12. Credit life insurance is usually written as what type of policy?

A. Whole life
B. Decreasing term
C. Increasing term
D. Adjustable life

13. An illustration used in the sale of a life insurance policy must include a label stating

A. "Representation of insurance"
B. "Guaranteed values"
C. "Life insurance illustration"
D. "Subject to change"

14. An insured in a group policy has misstated his age on the insurance application. As a result, the insurer will most likely

A. Adjust the premium.
B. Cancel the coverage.
C. Impose a fine on the insured.
D. Issue an amended policy.

15. Which of the following arrangements allows someone living with a life threatening condition to sell an existing life insurance policy and use the proceeds before death?

A. Collateral assignment
B. Viatical settlement
C. Modified endowment contract
D. Nonforfeiture law

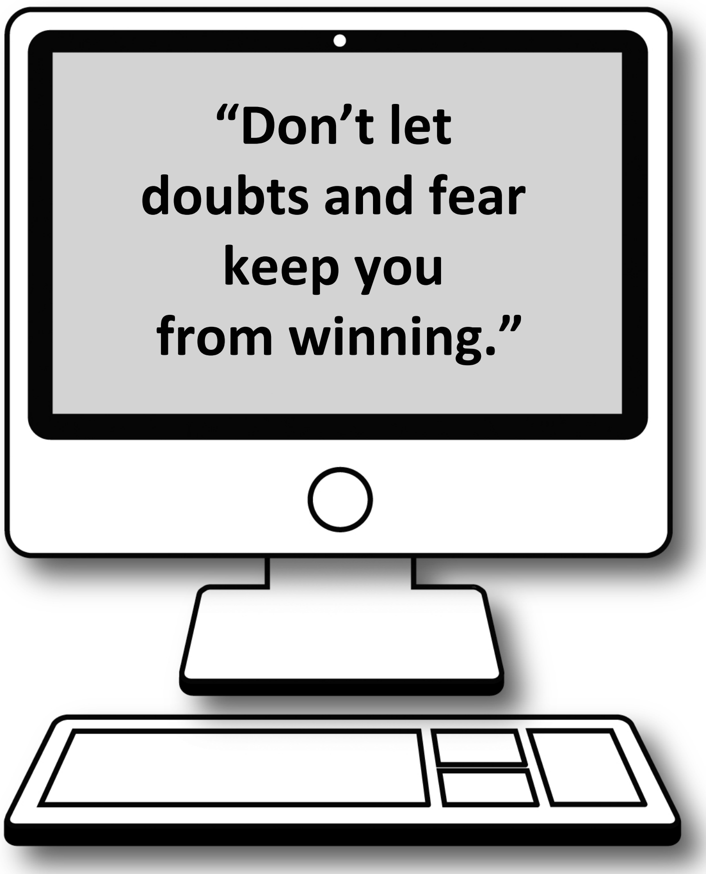
Answers to the quiz may be found in Appendix A.

FLASHBACK

Test your retention of the new concepts you learned. **Flashback** to the beginning of the chapter to review the **Snapshots** before moving forward.

VII

LIFE INSURANCE PRACTICE EXAM



VII. Life Insurance Practice Exam

1. The receipt given to a life insurance applicant when the application is completed and the initial premium is received is called a(n)

A. Insurable receipt.
B. Conditional receipt.
C. Unconditional receipt.
D. Insuring receipt.

2. Statements in the application for insurance that are believed to be true to the best of the applicant's knowledge are called

A. Warranties.
B. Representations.
C. Waivers.
D. Ambiguities.

3. All of the following apply to the waiver of premium rider EXCEPT

A. The premium is waived only if the insured is permanently disabled.
B. There is a waiting period of 6 months before the premium is waived.
C. The company continues the policy in force as if the premiums were being paid.
D. There is no charge for this rider.

4. An annuity is considered fixed when it does all of the following EXCEPT

A. Guarantees a minimum rate of return.
B. Provides level income payments.
C. Pays a specified dollar amount for each annuity benefit payment.
D. Provides the annuitant with either the guaranteed or current interest rate, whichever is less.

5. The most common type of whole life insurance where premiums are payable over the whole life of the insured to age 100 is called

A. Limited payment.
B. Life paid-up premium.
C. Continuous premium (straight) life.
D. Single premium whole life.

6. A beneficiary who has a vested interest in the proceeds of a life insurance policy is the

A. Irrevocable beneficiary.
B. Primary beneficiary.
C. Secondary beneficiary.
D. Contingent beneficiary.

7. The insured died four months after a $100,000 life insurance policy was issued and delivered. At the time of the claim, the company noticed the original application was missing some key information. What will the company do?

A. Return the premiums paid to the insured's estate
B. Pay the death claim because the insurer waived the right to obtain the missing information
C. Deny the claim
D. Require the beneficiary to furnish the missing information

8. The policy and a copy of the application, along with any riders and amendments, is called the

A. Whole contract.
B. Complete contract.
C. Entire contract.
D. Primary contract.

9. At what age can a participant receive distributions from a qualified plan without incurring a 10% penalty?

A. 45
B. 55 ½
C. 59
D. 59 ½

10. Which settlement option guarantees an income for two or more recipients for as long as they live?

A. Single Life option
B. Fixed Amount installments
C. Life Income
D. Joint and Survivor

11. Which type of policy allows the insured to change the amount of the death benefit, the amount of premium, or the type of coverage as their needs change?

A. Adjustable life
B. Universal life
C. Decreasing term life
D. Variable life

12. To prevent individuals from profiting from a loss, insurance companies must be certain that

A. The owner and the insured are related.
B. There is no cash value in the policy.
C. The face amount of the policy is only five times the insured's annual salary.
D. Insurable interest exists.

13. If a misstatement of age is discovered during the processing of a life insurance claim, what will the insurance company do?

A. Rescind the policy because incorrect information was given on the application.
B. Adjust the death benefit based on the premiums that were paid.
C. Automatically pay the total death benefit to the primary beneficiary.
D. Pay half of the death benefit to the primary beneficiary.

14. Each of the following is a typical characteristic of group life insurance EXCEPT

A. Evidence of insurability is usually required.
B. The master policy is issued to the sponsor of the group.
C. The plan has a grace period.
D. Individual certificates are issued.

15. A life settlement option that pays out the death benefit incrementally, in a specified amount until all of the proceeds are exhausted is called

A. Interest only.
B. Fixed-amount installments.
C. Fixed-period installments.
D. Life income.

16. A life insurance death benefit paid in a lump sum to a beneficiary is

A. Not subject to any taxes.
B. Not subject to estate taxes but subject to federal taxes.
C. Subject to federal taxes only.
D. Subject to federal, state, and estate taxes.

17. Which of the following reports would contain information concerning a person's character, reputation or habits collected through interviews with the person's associates or friends?

A. Investigative Consumer Report
B. Fair Credit Report
C. Consumer Report
D. Producer's Report

18. An annuity that is purchased with a lump-sum payment and begins income payments within one year is a

A. Single premium immediate annuity.
B. Periodic deferred annuity
C. Single premium deferred annuity.
D. Flexible deferred annuity.

19. Which statement is INCORRECT concerning policy dividends?

A. Dividends are not taxable.
B. The insurance company may guarantee dividends.
C. Policyowners have several options to receive dividends.
D. Dividends are paid on participating policies.

20. What is the risk classification for those who are insurable, but present a higher than average risk?

A. Standard
B. Preferred
C. Substandard
D. Declined

21. At age 25, an individual purchased a decreasing term policy. What does that say about the coverage and the premium?

A. Both the coverage and the premium decrease.
B. The premium decreases but the coverage stays the same.
C. The coverage decreases but the premium stays the same.
D. Neither the coverage nor the premium decreases, but all policy riders are removed after a predetermined number of years.

22. Underwriting is the process of

A. Writing policy forms to conform to state insurance department guidelines.
B. Comparing policies between insurance companies.
C. Dividing business between two insurance companies.
D. Determining the insurance company's risk regarding a proposed insured.

23. A whole life product that covers two lives and provides for payment of the death benefit on the death of the first insured is called

A. Universal Life.
B. Variable Life.
C. Joint and Survivor Life.
D. Joint Life.

24. A producer delivers a policy to an insured, but nine days later the insured returns the policy and wants a complete refund. What provision allows the insured to return the policy?

A. Consideration
B. Entire Contract
C. Free Look
D. Owner's Rights

25. Which of the following retirement plans is a special tax favored plan for nonprofit, charitable, educational or religious groups?

A. HR-10
B. 401(k)
C. 403(b) Tax-sheltered Annuity (TSA)
D. Simplified Employee Pension (SEP)

26. The MIB is a nonprofit trade association that maintains

A. Motorist information on applicants for life and health insurance.
B. Medical information on applicants for life and health insurance.
C. Maternity information on female applicants for life and health insurance.
D. Classifications of risk for previous policyowners.

27. What is the purpose of the grace period in life insurance policies?

A. To protect the policyowner against an unintentional lapse of the policy
B. To allow a month of free coverage
C. To allow the policyowner to examine the policy
D. To extend coverage past the end of the policy's term

28. What type of permanent insurance allows the policyowner to pay for a policy in a specified period of time, and the policyowner does not have to make any more premium payments for the life of the policy?

A. Single Premium
B. Indeterminate Premium
C. Limited Payment
D. Continuous Premium

29. What does the payor benefit rider protect?

A. Grace period for a whole policy
B. Disability claims benefits
C. Premium payments for a juvenile policy
D. Contestability

30. How long does an employee have to convert a group policy to an individual policy without evidence of insurability?

A. 10 days
B. 31 days
C. 60 days
D. 90 days

31. If the cash value exceeds the premiums paid in a whole life policy, what are the tax consequences if the policy is surrendered?

A. The portion that exceeds the premiums paid is taxable.
B. The total amount received when the policy is surrendered is taxable.
C. The interest earned is taxable.
D. The cash value is tax free.

32. Betty is the only beneficiary named on her husband Bob's policy which has a Common Disaster provision. They are in a car accident, and Bob dies instantly. Betty lives for 29 days. Who will receive the death benefit?

A. Betty
B. Betty's estate
C. Bob's children
D. Bob's estate

33. The legal transfer of all or part of a policyowner's rights, title or interest is called a(n)

A. Assignment.
B. Waiver.
C. Modification.
D. Counteroffer.

34. What do employees receive under a group contract?

A. Individual policy
B. Certificate of insurance
C. Master policy
D. Buyer's guide

35. An annuity in which investment growth is dependent on the performance of an index such as the Standard and Poor's 500 is called a(n)

A. S&P 500 Fixed Annuity.
B. Indexed Annuity.
C. Market Value Adjusted Annuity.
D. Variable Universal Annuity.

36. The premium payment mode can be best described as the

A. Amount of the policy premium.
B. Payment method of the policy premium.
C. Frequency with which the policy premium will be paid.
D. Mortality table used to calculate the premium.

37. Which of the following individuals would NOT sign an application for life insurance policy?

A. The beneficiary
B. The agent
C. The proposed insured
D. The owner if different from the insured

38. What should a producer do if information on an application for insurance is missing or needs to be corrected?

A. Correct the information, initial it, and send it to the insurance company.
B. Make the necessary corrections, re-sign the application, and return it to the applicant for countersignature.
C. Set up an appointment with the applicant to either complete a new application or correct the error and have the applicant initial the change.
D. Nothing, send the application to the insurance company for completion.

39. A universal life contract expires when

A. The outstanding loan equals the death benefit.
B. The cash value equals the death benefit.
C. The cash value account becomes too small to pay the cost of insurance.
D. A regularly scheduled premium payment is missed.

40. To reinstate the full death benefit of a life policy that has been kept in force by the Automatic Premium Loan provision, the policyowner must

A. Repay the loan plus interest.
B. Show proof of insurability.
C. Make another application.
D. Obtain insurance company approval of the reinstatement application.

41. Which rider would allow additional insurance at specified dates or events, without evidence of insurability?

A. Cost of Living
B. Return of Premium
C. Guaranteed Insurability
D. Disability Income

42. Variable Universal Life insurance offers a policyowner which of the following features?

A. Dividends that are guaranteed for the life of the policy
B. The ability to increase the death benefit
C. A face amount that must stay level
D. Premiums that increase each year for a specified number of years

43. The federal law that permits an applicant for insurance to question the validity and source of any credit information is called

A. Medical Information Bureau Disclosure Act.
B. USA PATRIOT Act.
C. Equal Opportunity Finance Act.
D. Fair Credit Reporting Act.

44. In a renewable term policy the additional premium pays for the right to renew the policy

A. With the same coverage amount regardless of the insured's health.
B. At the same premium amount.
C. With a higher coverage amount.
D. With the same premium amount regardless of the insured's health.

45. A current assumption or interest-sensitive whole life policy has

A. Premiums that may vary according to interest rate fluctuations.
B. Premiums that the policyowner may change based on certain assumptions.
C. A higher guaranteed cash value interest rate than traditional whole life policies.
D. Interest rate assumptions that allow the policyowner to change the policy every 5 years.

46. Which of the following is NOT a nonforfeiture option of a whole life policy?

A. Extended Term
B. Cash Surrender Value
C. Reduced Paid-up Insurance
D. Accumulate at Interest

47. The life insurance policy provision that prohibits an insurance company from denying a death claim after the policy has been in force for a specified period of time is the

A. Misstatement of age.
B. Incontestability.
C. Reinstatement.
D. Insuring clause.

48. When the business is the owner, premium payor, and beneficiary of a life insurance policy, this is an example of a(n)

A. Key person policy.
B. Buy-sell agreement.
C. Stock redemption plan.
D. Executive bonus plan.

49. If a producer accepts a completed application without the first premium, when does coverage become effective for the insured?

A. When the insurance company receives the application
B. When the insurance company approves the application
C. When the policy is delivered and the first premium is paid
D. When the last outstanding medical requirement is completed

50. All of the following statements about sources of underwriting are true EXCEPT

A. A medical examination is typically used when benefits are large.
B. The contents of an inspection report cannot be disclosed to the applicant.
C. The application is typically the principal source of information.
D. An attending physician's statement provides information about the applicant's prior medical conditions.

Answers to the practice exam may be found in Appendix A.

APPENDIX A: CHAPTER QUIZ ANSWER KEY

Chapter I: Completing the Application, Underwriting, and Delivering the Policy	Chapter II: Types of Life Policies	Chapter III: Policy Provisions, Riders, and Options
1. A	1. C	1. C
2. D	2. C	2. B
3. B	3. B	3. C
4. D	4. B	4. D
5. B	5. D	5. D
6. D	6. C	6. B
7. D	7. A	7. C
8. A	8. B	8. C
9. C	9. B	9. A
10. D	10. C	10. B
11. C	11. B	11. D
12. A	12. A	12. C
13. A	13. A	13. B
14. A	14. B	14. C
15. C	15. D	15. B

Chapter IV: Taxes, Retirement, and Other Insurance Concepts	Chapter V: Texas Statutes and Rules Common to Life and Health Insurance	Chapter VI: Texas Statutes and Rules Pertinent to Life Insurance Only
1. C	1. C	1. C
2. A	2. C	2. C
3. A	3. A	3. D
4. B	4. C	4. B
5. A	5. B	5. A
6. D	6. D	6. C
7. B	7. B	7. B
8. C	8. D	8. B
9. A	9. C	9. A
10. A	10. C	10. B
11. B	11. B	11. D
12. C	12. D	12. B
13. C	13. A	13. C
14. D	14. D	14. A
15. D	15. B	15. B

LIFE INSURANCE PRACTICE EXAM		
1. B	18. A	35. B
2. B	19. B	36. C
3. D	20. C	37. A
4. D	21. C	38. C
5. C	22. D	39. C
6. A	23. D	40. A
7. B	24. C	41. C
8. C	25. C	42. B
9. D	26. B	43. D
10. D	27. A	44. A
11. A	28. C	45. A
12. D	29. C	46. D
13. B	30. B	47. B
14. A	31. A	48. A
15. B	32. D	49. C
16. A	33. A	50. B
17. A	34. B	

APPENDIX B: SNAPSHOTS ANSWER KEY

Chapter I: Completing the Application, Underwriting, and Delivering the Policy

1. **What is insurance?**
   Insurance transfers the risk of loss from an individual or business entity to an insurance company, which in turn spreads the costs of unexpected losses to many individuals.
2. **In a life insurance policy, when must insurable interest exist?**
   Insurable interest must exist between the policyowner and the insured at the time of application, but not at the time of loss.
3. **What are the four elements of an insurance contract?**
   Agreement - offer and acceptance, consideration, competent parties, and legal purpose
4. **What does representation mean and how does it differ from a warranty?**
   Representations are statements believed to be true to the best of one's knowledge. A warranty is an absolutely true statement upon which the validity of the insurance policy depends.
5. **What does insurance solicitation mean?**
   In simplest terms, solicitation of insurance means an attempt to persuade a person to buy an insurance policy, and it can be done orally or in writing.
6. **What information does a Buyer's Guide provide?**
   Basic information about life insurance policies and comparison of policy cost
7. **What is underwriting?**
   Underwriting is the risk selection and classification process.
8. **What information is gathered in Parts 1 & 2 of the application?**
   Part 1 of the application includes the general questions about the applicant, including name, age, address, birth date, gender, income, marital status, and occupation. Part 2 includes medical information about prospective insured.
9. **What is the purpose of the agent's report?**
   The agent's (producer's) report is used by the agent to discuss his or her personal observations concerning the proposed insured.
10. **Who is required to sign an application for life insurance?**
    Both the agent and the proposed insured (usually the applicant) must sign the application.
11. **When does an insurance policy go in effect?**
    The policy will go into effect when the first premium is paid and the policy has been delivered.
12. **How can an insurance company use the information it obtains from the MIB?**
    It can use MIB information to conduct further investigation into an applicant's current insurability.
13. **What is the purpose of the Fair Credit Reporting Act?**
    The act established procedures that consumer-reporting agencies must follow in order to ensure that records are confidential, accurate, relevant, and properly used. It also protects consumers against the circulation of inaccurate or obsolete information.
14. **What is the difference between a consumer report and an investigative consumer report?**
    Investigative consumer reports are similar to consumer reports in that they also provide information on the consumer's character, reputation, and habits. The primary difference is that the information is obtained through an investigation and interviews with associates, friends and neighbors of the consumer.
15. **How does a substandard risk policy differ from a standard risk?**
    Substandard risk applicants are not acceptable at standard rates because of physical condition, personal or family history of disease, occupation, or dangerous habits. These policies could be issued with the premium rated-up (higher than the standard risk).

16. **What are the 3 factors that determine the premium for a particular policy?**
    Mortality, interest, and expense
17. **When is a policy considered delivered?**
    When the insurer relinquishes control of the policy by mailing it to the policyowner, legally the policy is considered delivered.
18. **When would an insured be required to sign a statement of good health?**
    If the initial premium is not paid with the application, the agent may need to obtain the statement of good health at policy delivery.

Chapter II: Types of Policies

1. **What are the characteristics of term life insurance?**
   It provides temporary, pure death protection, with no cash value.
2. **What is annually renewable term insurance?**
   Annually renewable term (ART) is the purest form of term insurance in which the death benefit remains level; the policy may be guaranteed renewable each year without proof of insurability, but the premium increases annually according to the attained age.
3. **What are the characteristics of whole life insurance?**
   Permanent protection to the insured's age 100, with living benefits such as cash value, policy loans, and nonforfeiture options.
4. **How does continuous premium straight life differ from 20-year limited pay life?**
   The premiums for straight life will be spread over the insured's lifetime, thus enabling the insurance company to charge a lower annual premium. When the premium-paying period is condensed to 20 years, a higher annual premium is required.
5. **What are the death benefit options in universal life policies?**
   Option A is the level death benefit option, and Option B is the increasing death benefit option
6. **Which authorities regulate variable life policies?**
   Variable life insurance products are dually regulated by the State and Federal Government: the Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA), and the State Department of Insurance.
7. **What qualifications must an individual obtain prior to selling variable life insurance products?**
   Registration with FINRA, a securities license, and a state issued license to sell life insurance
8. **How do annuities differ from life insurance policies?**
   Annuities liquidate an estate (life insurance creates an estate). Annuities pay income to the annuitant while he or she is still living; life insurance pays the death benefit.
9. **Who has all of the rights in an annuity contract?**
   The owner of the annuity has all of the rights such as naming the beneficiary and surrendering the annuity.
10. **What happens to the benefit if the annuitant dies during the accumulation period?**
    If the annuitant dies before annuitization (or payout period), his/her beneficiary will receive the amount paid into the plan or the cash value, whichever is greater.
11. **An annuity has 2 distinct periods. What are they called, and what happens during each?**
    The accumulation period, also known as the pay-in period, is the period of time over which the annuitant makes payments (premiums) into an annuity. The annuity period, also referred to as the annuitization period, liquidation period, or pay-out period, is the time when money is distributed to the annuitant.
12. **What are the 2 premium payment options in annuities?**
    Single premium and periodic premiums

13. **How does inflation affect the purchasing power of a fixed annuity?**
    Inflation can erode the purchasing power of income payments.
14. **How soon can payments begin in a deferred annuity?**
    In a deferred annuity, income payments begin sometime after one year from the date of purchase.

Chapter III: Life Policy Provisions, Riders, and Options

1. **What constitutes the entire contract?**
   The policy and a copy of the application, along with any riders or amendments, form the entire contract.
2. **What is a free-look period, and when does it begin?**
   It allows the policyowner a specified number of days after policy delivery to look over the policy, and if dissatisfied for any reason, return it for a full refund of premiums. The free-look period begins when the policyowner receives the policy, not when the insurer issues it.
3. **What is the difference between absolute and collateral assignment?**
   An absolute assignment permanently transfers all rights of ownership to another person; a collateral assignment is a transfer of partial rights.
4. **What is the purpose of a grace period?**
   To prevent unintentional policy lapse for nonpayment of premium
5. **What is the difference between a revocable and irrevocable beneficiary?**
   The policyowner may change a revocable beneficiary at any time. An irrevocable designation, however, has a vested interested in the policy and may not be changed without the beneficiary's written consent.
6. **What happens to an unpaid policy loan at insured's death?**
   If there are outstanding loans at the time of the insured's death, the amount will be considered a debt to the policy and the death benefit will be reduced by the amount of indebtedness.
7. **What is the purpose of the Automatic Premium Loan provision?**
   It prevents the unintentional lapse of a policy due to nonpayment of the premium.
8. **Which riders increase the amount of the death benefit?**
   Accident Death rider - pays double or triple the amount of face value, Cost of Living rider - automatically increases the amount of insurance based on an inflation index, Return of Premium - pays back all the premiums in addition to the death benefit, and some others.
9. **Which rider allows the early payment of a portion of the death benefit to the insured?**
   Accelerated death benefit rider
10. **What are the 3 nonforfeiture options in life insurance policies?**
    Cash surrender value, reduced paid-up insurance or extended term option
11. **Which nonforfeiture option is automatically selected if the policyowner has not made a selection?**
    If the policyowner has neglected to select one of these nonforfeiture options, the insurer will automatically implement the extended term option in the event of termination of the original policy.
12. **Which dividend option increases the death benefit?**
    Paid-up additions increase the death benefit of the original policy by whatever amount the dividend will buy.
13. **What settlement options are available in life insurance policies?**
    Cash payment (lump sum), life income, interest only, fixed-period installments, and fixed-amount installments

Chapter IV: Taxes, Retirement, and Other Insurance Concepts

1. **Who owns a group life contract? What does the insured receive?**
   The actual policy (master policy/contract) is issued to the sponsor of the group, which is often an employer. The employees are the insured who are issued certificates of insurance.
2. **What are some of the group characteristics important for underwriting?**
   Purpose, size, turnover and financial strength of the group
3. **What are the general requirements for qualified plans?**
   The plan must be for the exclusive benefit of the employees and their beneficiaries, must be formally written and communicated to the employees, and cannot discriminate in favor of the prohibited group. The plan must be permanent, approved by the IRS, and have a vesting requirement.
4. **Who can contribute to a traditional IRA?**
   Individuals or married couples with earned income, up to the age of 70 1/2
5. **What are the main differences between a traditional IRA and a Roth IRA?**
   Contributions are after tax and can continue beyond age 70½. Distributions do not have to begin at age 70½.
6. **What are the consequences of withdrawing money from a traditional IRA prior to age 59½?**
   10% penalty on distribution unless it qualifies for an exemption
7. **Who is eligible for a Keogh (HR-10) Plan?**
   A self-employed individual or a partner working part or full time who owns at least 10% of the business
8. **What is the maximum number of participants in a SIMPLE plan?**
   100 employees
9. **How are income payments from a 403(b) plan taxed?**
   Funds contributed are excluded from the employee's current taxable income, but are taxable upon withdrawal.
10. **What are some common personal uses of life insurance?**
    Survivor protection, estate creation and conservation, cash accumulation, and liquidity
11. **What is the purpose of key-person insurance?**
    To minimize the risk of a financial loss because of the premature death of a key employee that has specialized knowledge, skills or business contacts
12. **How are life insurance death proceeds taxed?**
    If taken as a lump sum, proceeds are tax free. If other than lump sum, principal is tax free and interest is taxable.
13. **How are dividends taxed in participating policies?**
    Dividends are the return of unused premiums, so they are not considered income for tax purposes. If dividends are left with the insurer to accumulate interest, the interest earned on the dividend account is subject to taxation as ordinary income each year interest is earned.
14. **How do accelerated benefits differ between terminally ill and chronically ill insureds?**
    Benefits to a terminally ill insured are received tax free, while benefits paid to a chronically ill insured are tax free up to a certain limit.
15. **When does a life insurance policy become a Modified Endowment Contract?**
    Any life insurance policy that fails a 7-pay test is classified as a Modified Endowment Contract (MEC), and loses the standard tax benefits of a life policy.
16. **In regards to Social Security, what does the term *fully insured* mean?**
    It refers to someone who has earned 40 quarters of coverage, and is, therefore, entitled to receive Social Security retirement, Medicare, and survivor benefit.

Chapter V: Texas Statutes and Rules
Common to Life and Health Insurance

1. **What is included under the term insurance transaction?**
   Solicitation, negotiating prior to execution of a contract, execution of a contract, and the transaction of any matters that arise as a result of the contract, as well as the actual process of insuring
2. **What is the difference between domestic, foreign, and alien insurance companies?**
   A domestic insurer is incorporated in this state. A foreign insurer is incorporated in another state. An alien insurer is incorporated outside the United States.
3. **What is the difference between an authorized/admitted and unauthorized/nonadmitted insurer?**
   An admitted or authorized insurer is qualified and received a Certificate of Authority from the Department of Insurance to transact insurance in the state. A nonadmitted or nonauthorized insurer is an insurance company that has not applied for, or has been denied a Certificate of Authority and may not transact insurance.
4. **What document must an insurance company hold to transact insurance business in Texas?**
   Certificate of Authority
5. **What are the duties of the Commissioner?**
   Regulate DOI affairs, prescribe forms and procedures, aid in interpretation of laws, issue licenses and certificates of authority. *Please review the complete list in the text.*
6. **When can the Commissioner examine an insurer's or agent's records?**
   As often as deemed necessary, but at least once every 5 years
7. **What factors help determine the amount of an administrative penalty?**
   The seriousness of the violation and whether or not it was intentional. *Review the text for a complete list.*
8. **Who do agents represent?**
   Agents represent the insurance company.
9. **How long can a temporary license be in effect?**
   90 days
10. **How often are producers required to renew their license?**
    Every 2 years
11. **If a producer's license has been revoked, how long must the producer wait before reapplying for a new license?**
    5 years
12. **What constitutes rebating?**
    Rebating includes premiums payable on the policy, special favors or services, advantages in dividends or benefits, stocks, bonds, securities, and their profits (and similar inducements).
13. **Can agents or insurers advertise protection by the Insurance Guaranty Association?**
    It is considered an unfair trade practice to advertise protection by the Insurance Guaranty Association when selling any product that is covered by the Association.

Chapter VI: Texas Statutes and Rules
Pertinent to Life Insurance Only

1. **What does *insurance solicitation* mean?**
   Solicitation of insurance means an attempt to persuade a person to buy an insurance policy, and it can be done orally or in writing.
2. **Who is responsible for all written and distributed insurance advertisements?**
   The insurer whose policies are advertised is responsible for all its advertisements, regardless of who wrote, created, presented, or distributed them.

3. **How long is the incontestability period in life insurance policies issued in this state?**
   2 years (except in the cases of fraud)
4. **What are the minimum required nonforfeiture options in life insurance policies issued in this state?**
   Reduced paid-up, extended term, and shortened benefit period
5. **Who is the owner and who is the beneficiary of a credit life policy?**
   The creditor is the owner and the beneficiary of the policy.
6. **What is the limit on the amount of credit life insurance on a debtor?**
   The amount of credit life on a debtor cannot exceed the amount owed to the creditor.
7. **What are the steps a producer must complete when replacing an existing policy?**
   (1) Give applicant a Notice Regarding Replacement; (2) Obtain a list of all existing life insurance policies to be replaced; (3) Give the applicant the original or a copy of written or printed communications used for presentation to the applicant; and (4) Submit to the replacing insurance company, with the application, a copy of the replacement notice.

GLOSSARY

Accelerated Benefits - Riders attached to life insurance policies that allow death benefits to be used to cover nursing or convalescent home expenses.
Accidental Death Benefits - A policy rider that states that the cause of death will be analyzed to determine if it complies with the policy description of accidental death.
Accidental Death Insurance - An insurance policy that provides payment if the insured's death is the result of an accident.
Accumulation Period - The time before an annuitant's retirement during which the annuitant is making payments or investments in an annuity.
Actual Cash Value (ACV) - The required amount to pay damages or for property loss. This amount is calculated based on the property's current replacement value minus depreciation.
Adhesion - A contract offered on a "take-it-or leave-it" basis by an insurer, in which the insured's only option is to either accept or reject the contract. Any ambiguities in the contract will be settled in favor of the insured.
Adjustable Life - Life insurance that permits changes in the face amount, premium amount, period of protection, and the duration of the premium payment period.
Adjuster - A representative of an insurance company who investigates and acts on the behalf of the company to obtain agreements for the amount of the insurance claim.
Administrator - An individual appointed by a court as a fiduciary to settle the financial affairs and estate of a deceased person.
Admitted (Authorized) Insurer - An insurance company authorized and licensed to transact business in a particular state.
Adverse Selection - The tendency of risks with higher probability of loss to purchase and maintain insurance more often than the risks who present lower probability.
Agency - An insurance sales office or company.
Agent - An individual who is licensed to sell, negotiate, or effect insurance contracts on behalf of the insurer.
Agent Appointment - The authorization of an agent to act for or represent an insurer
Agent's Authority - Special powers granted to an agent by his or her agency contract.
Aleatory - A contract in which participating parties exchange unequal amounts. Insurance contracts are aleatory in that the amount the insured will pay in premiums is unequal to the amount the insurer will pay in the event of a loss.
Alien Insurer - An insurance company that is incorporated outside the United States.
Annual Statement - A detailed financial report that an insurance company must submit every year to the insurance department of state(s) in which it conducts business.
Annuity - A contract that provides income for a specified period of years, or for life.
Apparent Authority - The appearance or the assumption of authority based on the actions, words, or deeds of the principal or because of circumstances the principal created.
Applicant - A person making application for, or offering himself, herself or another to be insured under an insurance contract.
Application - A document that provides information for underwriting purposes. After the policy is issued, any unanswered questions are considered waived by the insurer.
Assignment - The transfer of ownership rights of a life insurance policy from one person to another.
Attained Age - The age of the insured at a determined date.
Attending Physician's Statement (APS) - A statement usually obtained from the applicant's doctor.
Authorized (Admitted) Insurer - An insurance company authorized and licensed to transact business in a particular state.
Avoidance - A method of dealing with risk by deliberately keeping away from it (e.g. if a person wanted to avoid the risk of being killed in an airplane crash, he or she might choose to never fly in a plane).

Basic Illustration - A ledger or proposal used in the sale of a life insurance policy that shows both guaranteed and nonguaranteed elements.
Beneficiary - The person who receives the proceeds from the policy when the insured dies.
Birthday Rule - The method of determining primary coverage for a dependent child, under which the plan of the parent whose birthday occurs first in the calendar year is designated as primary.
Broker - An individual who represents an insured in the process of purchasing and negotiating a contract of insurance.
Buy-Sell Agreement - A legal contract that determines what will be done with a business in the event that an owner dies or becomes disabled.
Buyer's Guide - A booklet that describes insurance policies and concepts, and provides general information to help an applicant make an informed decision.
Cash Value - The amount to which a policyowner is entitled if the policy is surrendered before maturity.
Certificate - A statement or booklet that confirms that a policy has been written and that describes the coverage in general.
Certificate of Authority - A document that authorizes a company to start conducting business and specifies the kind(s) of insurance a company can transact. It is illegal for an insurance company to transact insurance without this certificate.
Certificate of Insurance - A legal document that indicates that an insurance policy has been issued, and that states both the amounts and types of insurance provided.
Claim - A request for payment of the benefits provided by an insurance contract.
Coercion - An unfair trade practice in which an agent uses physical or mental force with the intent of inducing an applicant to purchase insurance.
Coinsurance Clause - A provision that states that the insurer and the insured will share the losses covered by the policy in a proportion agreed upon in advance.
Commingling - A practice in which a person in a fiduciary capacity illegally mixes his/her personal funds with funds he/she is holding in trust.
Commission - The payment made by insurers to agents or brokers for the sale and service of policies.
Commissioner - The chief executive and administrative officer of a state insurance department (in some states, known as Director or Superintendent).
Concealment - The withholding of known facts that, if material, can void a contract.
Conditional Contract - A type of an agreement in which both parties must perform certain duties and follow rules of conduct to make the contract enforceable.
Consideration - The binding force in a contract that requires something of value to be exchanged for the transfer of risk. The consideration on the part of the insured is the representations made in the application and the payment of premium; the consideration on the part of the insurer is the promise to pay in the event of loss.
Consumer Report - A written and /or oral statement regarding a consumer's credit, character, reputation, or habits collected by a reporting agency from employment records, credit reports, and other public sources.
Contract - An agreement between two or more parties enforceable by law.
Contributory - A group insurance plan that requires the employees to pay part of the premium.
Controlled Business - An entity that obtains and possesses a license solely for the purpose of writing business on the owner, immediate family, relatives, employer or employees.
Convertible - A policy that may be exchanged for another type of policy by contractual provision, at the option of the policyowner, and without evidence of insurability (i.e. term life changed to a form of permanent life).
Countersignature - The act of signing an insurance policy by a licensed resident agent.
Coverage - The inclusion of causes of loss (perils) which are covered within a scope of a policy.
Credit Life Insurance - A special type of coverage written to pay off the balance of a loan in the event of the death of the debtor.

Death Benefit - The amount payable upon the death of the person whose life is insured.
Decreasing Term - A type of life insurance that features a level premium and a death benefit that decreases each year over the duration of the policy.
Defamation - An unfair trade practice in which one agent or insurer makes an injurious statement about another with the intent of harming the person's or company's reputation.
Dependent - A person who relies on another for support and maintenance.
Director - The chief executive and administrative officer of the Insurance Department (in some states, known as Commissioner or Superintendent).
Disclosure - An act of identifying the name of the producer, representative or firm, limited insurance representative, or temporary insurance producer on any policy solicitation.
Domestic Insurer - An insurance company that conducts business in the state of incorporation.
Domicile of Insurer - Insurer's location of incorporation and the legal ability to write business in a state.
Earned Premium - The amount of the premium for which the policy protection has been given.
Effective Date - The date when an insurance policy begins (also known as the inception date).
Employee Retirement Income Security Act (ERISA) - The act that stipulates federal standards for private pension plans.
Endorsement - A form changing the provisions of and attached to a life insurance policy (also known as a rider).
Endow - To reach the maturity date or time at which the face amount equals cash values.
Estoppel - A legal impediment to denying a fact or restoring a right that has been previously waived.
Excess Insurance - Insurance that pays over and above or in addition to basic policy limits.
Exclusions - Causes of loss, exposures, conditions, etc. listed in the policy for which the benefits will not be paid.
Expiration - The date specified in the policy as the date of termination.
Express Authority - The authority granted to an agent by means of the agent's written contract.
Extension of Benefits - A provision that allows coverage to continue beyond the policy's expiration date for employees who are not actively at work due to disability or who have dependents hospitalized on that date. This coverage continues only until the employee returns to work or the dependent leaves the hospital.
Face - The first page of a policy.
Fair Credit Reporting Act - A federal law that established procedures consumer-reporting agencies must follow in order to ensure that records are confidential, accurate, relevant and properly used.
Fiduciary - An agent/broker who handles insurer's funds in a trust capacity.
Fixed Annuity - An annuity that offers fixed payments and guarantees a minimum rate of interest to be credited to the purchase payment or payments.
Flexible Premium - A policy feature that allows the policyholder to vary premium payments in the amount and/or timing.
Foreign Insurer - An insurance company that is incorporated in another state.
Fraternal Benefit Societies - Life or health insurance companies formed to provide insurance for members of an affiliated lodge, religious organization, or fraternal organization with a representative form of government.
Fraud - Intentional misrepresentation or deceit with the intent to induce a person to part with something of value.
Free Look - A period of time, usually required by law, during which a policyowner may inspect a newly issued individual life or health insurance policy for a stated number of days and surrender it in exchange for a full refund of premium if not satisfied for any reason.
Grace Period - Period of time after the premium due date during which premiums may still be paid, and the policy and its riders remain in force.
Group Life - Life insurance provided for members of a group.
Hazard - A circumstance that increases the likelihood of a loss.

Hazard, Moral - The effect of a person's reputation, character, living habits, etc. on his/her insurability.
Hazard, Morale - The effect a person's indifference concerning loss has on the risk to be insured.
Hazard, Physical - A type of hazard that arises from the physical characteristics of an individual, such as a physical disability due to either current circumstance or a condition present at birth.
Implied Authority - Authority that is not expressed or written into the contract, but which the agent is assumed to have in order to transact the business of insurance for the principal.
Indemnify - To restore the insured to the same condition as prior to loss with no intent of loss or gain.
Insolvent organization - A member organization which is unable to pay its contractual obligations and is placed under a final order of liquidation or rehabilitation by a court of competent jurisdiction.
Insurability - The acceptability of an applicant who meets an insurance company's underwriting requirements for insurance.
Insurable Interest - A financial interest in the life of another person; a possibility of losing something of value if the insured should die. In life insurance, insurable interest must exist at the time of policy application or policy issue.
Insurance - A contract whereby one party (insurer) agrees to indemnify or guarantee another party (insured) against a loss by a specified future contingency or peril in return for payment of a premium.
Insured - The person or organization that is protected by insurance; the party is to be indemnified.
Insurer - An entity that indemnifies against losses, provides benefits, or renders services (also known as "company" or "insurance company").
Insuring Clause - A general statement that identifies the basic agreement between the insurance company and the insured, usually located on the first page of the policy.
Intentional Injury - An act that is intended to cause injury. Self-inflicted injuries are not covered under accident insurance; intentional injuries inflicted on the insured by another are covered.
Investigative Consumer Reports - A report similar to consumer report, but one that also provides information on the consumer's character, reputation and habits.
Issue Age - The individual's age when a policy is issued.
Joint Life - A single policy that is designed to insure two or more lives.
Juvenile Life - Any life insurance written on the life of a minor.
Lapse - Termination of a policy because the premium has not been paid by the end of the grace period.
Law of Large Numbers - A principle stating that the larger the number of similar exposure units considered, the more closely the losses reported will equal the underlying probability of loss.
Level Premium - A policy premium that remains the same over the period of time premiums are paid.
Life Expectancy - Average number of years remaining for a person of a given age to live, as shown on the mortality table.
Life Settlement - An arrangement that allows the policyowner sell their existing life insurance policy to a third party for compensation.
Limited-Pay Whole Life - A variation of whole life insurance that charges a level annual premium and provides a level, guaranteed death benefit to the insured's age 100 and will endow for the face amount if the insured lives to age 100. Limited-pay life is designed so that the premiums for coverage will be completely paid-up well before age 100.
Liquidation - Selling assets as a method of raising capital.
Living Benefits Rider - A rider attached to a life insurance policy that provides LTC benefits or benefits for the terminally ill by using available life insurance benefits.
Lloyd's Associations - Organizations that provide support facilities for underwriters or groups of individuals that accept insurance risk.
Loan Value - The amount of money an insured can borrow using the cash value of his/her life insurance policy as collateral.

Loss - The reduction, decrease, or disappearance of value of the person or property insured in a policy, by a peril insured against.
Lump Sum - Settlement method that pays the beneficiary the entire proceeds of a life insurance policy in one payment rather than in installments.
Market Value Adjusted Annuity - a single-premium deferred annuity that allows a contract owner to lock in a guaranteed interest rate over a specified maturity period.
Maturity Date -The date when the face amount of the life insurance becomes payable.
Medical Information Bureau (MIB) - An information database that stores the health histories of individuals who have applied for insurance in the past. Most insurance companies subscribe to this database for underwriting purposes.
Misrepresentation - A false statement or lie that can render the contract void.
Mode of Payment - The method of premium payment, whether annually, semiannually, quarterly, or monthly.
Mortality Table - A table showing the probability of death at specified ages.
Mutual Companies - Insurance organizations that have no capital stock, but are owned by the policyholders.
Nonadmitted (Nonauthorized) - An insurance company that has not applied for, or has applied and been denied a Certificate of Authority and may not transact insurance in a particular state.
Nonauthorized (Nonadmitted) - An insurance company that has not applied for, or has applied and been denied a Certificate of Authority and may not transact insurance in a particular state.
Noncancellable - An insurance contract that the insured has a right to continue in force by payment of premiums that remain the same for a substantial period of time.
Nonforfeiture Values - Those guaranteed values in a life insurance policy that cannot be taken from the insured, even if he or she ceases to pay premiums.
Nonmedical - A life or health insurance policy that is underwritten based on the insured's statement of health rather than a medical examination.
Nonparticipating Policies (Non-par) - Insurance that does not pay dividends.
Nonqualified Plan - A type of benefit plan that may discriminate, is not required to be filed with the IRS, and does not provide a current tax deduction for contributions.
Nonrenewal - A termination of a policy by an insurer on the anniversary or renewal date.
Nonresident Agent - An agent licensed in a state in which he or she is not a resident.
Option - A choice of ways of receiving policy dividends, nonforfeiture values, death benefits, or cash values.
Overinsurance - An excessive amount of insurance that would result in overpayment to the insured in the event of a loss.
Paid-Up Insurance - A policy on which all premiums have been paid but which has not matured due either to death or endowment.
Participating Policies (Par) - Insurance that pays dividends to policyholders.
Payor Benefit - A rider found in juvenile policies which waives the premiums if the person paying them (often the parent) is disabled or dies while the child is still a minor.
Peril - The cause of a possible loss.
Permanent Life Insurance - A general term used to refer to various forms of whole life insurance policies that remain in effect to age 100 so long as the premium is paid.
Persistency - The tendency or likelihood of insurance policies not lapsing or being replaced with insurance from another insurer.
Personal Contract - An agreement between an insurance company and an individual that states that insurance policies cover the individual's insurable interest.
Physical Exam and Autopsy - A provision that allows an insurer, at its own expense, to have an insured physically examined when a claim is pending or to have an autopsy performed where not prohibited by law.
Policy Loan - A nonforfeiture value in which an insurer loans a part or all of the cash value of the policy assigned as security for the loan to the policyowner.

Policyholder - The person who has possession of the policy, usually the insured.
Policyowner - The person who is entitled to exercise the rights and privileges in the policy. This person may or may not be the insured.
Preferred Risk - An insurance classification for applicants who have a lower expectation of incurring loss, and who, therefore, are covered at a reduced rate.
Premium - A periodic payment to the insurance company to keep the policy in force.
Primary Beneficiary - The person who is named as first to receive benefits from a policy.
Primary Policy - A basic, fundamental insurance policy which pays first with respect to other outstanding policies.
Principal Amount - The full face value of a policy.
Private Insurance - Insurance furnished by nongovernmental insuring organizations.
Pro Rata Cancellation - Termination of an insurance policy, with an adjustment of the premium charge in proportion to the exact coverage that has been in force.
Proceeds - The amount payable by the insurance company, usually in at the insured's death or when the policy matures.
Producer - Insurance agent or broker.
Pure Protection - Insurance whereby premiums are paid for protection in the event of death or disability, not for cash value accumulation.
Qualified Plan - A retirement plan that meets the IRS guidelines for receiving favorable tax treatment.
Rate Service Organization - An organization that is formed by, or on behalf of, a group of insurers to develop rates for those insurers, and to file the rates with the insurance department on behalf of its members. They may also act as a collection point for actuarial data.
Rebating - Any inducement offered in the sale of insurance products that is not specified in the policy.
Reciprocal Exchange - An unincorporated group of individuals who mutually insure one another, each separately assuming a share of each risk.
Reciprocity - A situation in which two parties provide the same help or advantages to each other (for example, Producer A living in State A can transact business as a nonresident in State B if State B's resident producers can transact business in State A).
Reduction - Lessening the possibility or severity of a loss.
Reinsurance - A form of insurance whereby one insurance company (the reinsurer) in consideration of a premium paid to it, agrees to indemnify another insurance company (the ceding company) for part or all of its liabilities from insurance policies it has issued.
Renewability Clause - A clause that defines the insurance company's and the insured's right to cancel or renew coverage.
Renewable Term - Insurance which can, at the election of the policyowner, be renewed at the end of a term without evidence of insurability.
Representations - Statements made by the applicant on the insurance application that are believed to be true, but are not guaranteed to be true.
Rescission - The termination of an insurance contract due either to material misrepresentation by the insured or by fraud, misrepresentation, or duress on the part of the agent/insurer.
Retention - A method of dealing with risk by intentionally or unintentionally keeping a portion of it for the insured's account; the amount of responsibility assumed but not reinsured by the insurance company.
Rider - Any supplemental agreement attached to and made a part of the policy indicating the policy expansion by additional coverage, or a waiver of a coverage or condition.
Risk - Uncertainty as to the outcome of an event when two or more possibilities exist.
Risk, Pure - The uncertainty or chance of a loss occurring in a situation that can only result in a loss or no change.
Risk Retention Group - A liability insurance company owned by its members, which are exposed to similar liability risks by virtue of being in the same business or industry.

Risk, Speculative - The uncertainty or chance of a loss occurring in a situation that involves the opportunity for either loss or gain.
Risk, Standard - An applicant or insured who is considered to have an average probability of a loss based on health, vocation and lifestyle.
Risk, Substandard - An applicant or insured who has a higher than normal probability of loss, and who may be subject to an increased premium.
Rollover - Withdrawing the money from a qualified plan and placing it into another qualified plan.
Secondary Beneficiary - The person who is named to receive benefits upon the death of the insured if the (primary) first-named beneficiary is no longer alive or does not collect all the benefits due to his/her own death.
Settlement Options - Choices available to the insured/owner for distribution of insurance proceeds.
Sharing - A method of dealing with risk for a group of individual persons or businesses with the same or similar exposure to loss who share the losses that occur within that group.
Single Premium Whole Life (SPWL) - A life insurance policy designed to provide a level death benefit to the insured's age 100 for a one-time, lump sum payment.
Speculative Risk - An uncertainty or chance of a loss occurring in a situation that involved the opportunity for either loss or gain.
Spendthrift Clause - A clause that prevents the debtors of a beneficiary from collecting the benefits before he/she receives them.
Standard Provisions - Requirements approved by state law that must appear in all insurance policies.
Standard Risk - An applicant or insured who is considered to have an average probability of a loss based on health, vocation and lifestyle.
Stock Companies - Companies owned by the stockholders whose investments provide the capital necessary to establish and operate the insurance company.
Straight Life - A basic policy that charges a level annual premium for the lifetime of the insured and provides a level, guaranteed death benefit.
Substandard Risk - An applicant or insured who has a higher than normal probability of loss, and who may be subject to an increased premium.
Superintendent - The head of the state department of insurance (in some states, known as Commissioner or Director).
Surrender - An act of giving up a life policy, in which the insurer will pay the insured the cash value the policy has built up.
Term Insurance - Insurance that provides protection for a specific period of time.
Terminally Ill - A person who is expected to die within a short period of time due to a specific illness or sickness.
Total Disability - A condition which does not allow a person to perform the duties of any occupation for payment as a result of injury or sickness.
Transfer - A basic principle of insurance under which the risk of financial loss is assigned to another party.
Twisting - A form of misrepresentation in which an agent persuades an insured/owner to cancel, lapse, or switch policies, even when it's to the insured's disadvantage.
Underwriter - A person who evaluates and classifies risks to accept or reject them on behalf of the insurer.
Underwriting - The process of reviewing, accepting or rejecting applications for insurance.
Unearned Premium - The portion of premium for which policy protection has not yet been given.
Unilateral Contract - A contract that legally binds only one party to contractual obligations after the premium is paid.
Universal Life - A combination of Annual Renewable Term and a cash account invested in the general fund of the insurance company.

Utmost Good Faith - The fair and equal bargaining by both parties in forming the contract, where the applicant must make full disclosure of risk to the company, and the insurance company must be fair in underwriting the risk.

Valued Contract - A contract that pays a stated amount in the event of a loss (disability insurance/life insurance).

Waiting Period - Time between the beginning of a disability and the start of disability insurance benefits.

Waiver - The voluntary abandonment of a known or legal right or advantage.

Waiver of Cost - A disability rider, found in Universal Life Insurance, that waives the cost of the insurance but does not waive the cost of premiums necessary to accumulate cash values.

Waiver of Premium - Continuation of life insurance coverage if the insured becomes totally disabled and is unable to pay the premiums.

Warranty - A material stipulation in the policy that if breached may void coverage.

Whole Life Insurance - Insurance that is kept in force for a person's entire life and pays a benefit upon the person's death, whenever that may be.

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The Personalized Study Plan follows the chapters in your course book and directs you to the topics you need to know before you take the state insurance exam. Additionally, your Licensing Coach will be there for you every step of the way, teaching you what you need to know and providing the guidance, support and motivation you need to ensure your success.

Licensing Coach
Contact Information

Name ________________________

Email Address _________________

Phone Number ______________

"Winners demand for themselves success and happiness and fulfillment. Winners have what I call a 'can do' attitude. There's nothing you can't do if you want it bad enough." - A.L. Williams

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☐ ***Review and implement your personalized study plan.***

- Review the personalized study plan that you prepared during class and identify areas where you need to improve your knowledge.
- Use your course book to study the topics you checked.
- If 🎬 is shown next to one of your highlighted study topics, review the Life Exam Review video that covers that topic on POL's Study Tool page at www.primericaonline.com.
- Talk to your Licensing Coach if you need help mastering the topics you need to know for the state exam.

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- Log onto POL (www.primericaonline.com) and click the "PassNow" link in the "Prepare" section of your Scoreboard to get started!
- The Practice Test will measure how prepared you are for the state exam. Your score sheet will tell you if you're ready to pass or need additional study time:
    - **GREEN** = Ready to take the state exam
    - **YELLOW** = Take Focused Exams until you get a "GREEN, Ready to Test" on your score sheet
- Take a Focused Exam while you're waiting for your exam day to arrive. It covers ONLY those areas you missed so you'll be even better prepared to conquer the state exam.

☐ ***Additional Study Tools — See the Additional Study Tools page for more great tools.***

☐ ______________________________

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Texas

Primerica Life Insurance Company
Prelicensing Life Curriculum Outline

October 2016

SUBJECT	TIME
Session A Orientation to Prelicensing Course **Chapter I**: Completing the Application, Underwriting, and Delivering the Policy *Review and Chapter Quiz* **Chapter II**: Types of Life Policies	**4.0 hours**
Session B **Chapter II Cont.**: Types of Life Policies *Review and Chapter Quiz* **Chapter III**: Life Policy Provisions Riders and Options	**4.0 hours**
Session C **Chapter III Cont.**: Life Policy Provisions Riders and Options, continued *Review and Chapter Quiz*	**4.0 hours**
Session D **Chapter IV**: Taxes, Retirement, and Other Insurance Concepts *Review and Chapter Quiz* **Chapter V**: TX Rules and Regulations Common to all Lines *Review and Chapter Quiz* **Chapter VI**: TX Rules and Regulations Pertinent to Life Insurance Only *Review and Chapter Quiz*	**4.0 hours**
TOTAL HOURS	**16.0 Hours**

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Insurance Terms for Success: Download audio files to your mobile devices to review terms you need to know when you're "on the go!"

Exam Taking Tips: Don't be nervous about taking the state exam. Get some great tips to ease your mind and give you the confidence you need to pass.