LIFE SECTION 2

POLICY RIDERS, PROVISIONS, OPTIONS AND EXCLUSIONS

A. <u>Life Insurance Policy Riders</u> (these are added to the policy to make it better)

1. <u>Waiver of Premium and Waiver of Premium with Disability Income</u> (WP)

    a. A type of <u>disability income insurance</u> added to a life policy
    b. Very inexpensive
    c. Will pay the premium if the insured becomes <u>totally disabled</u>
    d. Has a <u>6-month waiting period</u>
        1. Insured must pay any premium due during the waiting period
        2. If insured satisfies waiting period the insurer will reimburse insured for any premiums paid during the 6-month waiting period
    e. The premiums will be waived and the policy will remain in force for as long as the insured is still disabled
    f. Often time this rider must be enacted before age 60 (drops off at a certain age)
    g. If added with disability income as well, the policy pays the insured's net income monthly during time of total disability
        1. This disability income rider would cost extra

2. <u>Guaranteed Insurability Rider</u> (GIR)

    a. May be added to policies of younger applicants
    b. Enables insured to increase coverage later <u>regardless of health</u>
        1. Has 5 or more option dates to increase coverage
        2. Option dates usually occur at 2 or 3-year intervals
            a. If an option date is skipped, it is lost
    c. At each option date, the insured may purchase an additional policy, up to the original policy's face amount
    d. At each increase, <u>rates are based upon current (attained) age of insured</u>
    e. Extra option dates are often given for marriage or birth of a child

3. <u>Payor Benefit Rider</u>

    a. Similar to waiver of premium rider
    b. Added to a policy written on the life of the child
    c. <u>Waives the premium if the premium payor dies or becomes disabled</u> - payor is usually a parent or grandparent
        1. Has a 6-month waiting period for disability only
    d. Expires when child reaches age 18
        1. Child must assume premium payments at that time

4. Accidental Death Benefit Rider (sometimes called AD&D rider)
    a. A type of accident insurance added to a life policy
    b. Sometimes called multiple indemnity rider
    c. Pays double the face amount (sometimes triple) if the insured dies as a result of an accident
    d. Death must occur within 90 days of the accident or it is assumed to be from natural causes
    e. Does not cover death due to sickness, only accidents
    f. Pays a stated amount if the insured is blinded in an accident (AD&D rider)

5. Term Insurance Riders

    a. Often added to a whole life policy to increase coverage
    b. Makes coverage more affordable
    c. Insured buys some whole life, some term
        1. Term coverage may be level or decreasing
    d. Term portion will not cover unless insured dies within the term period
        1. Term policy will eventually expire, but whole life will continue to age 100
    e. Similar to buying two policies, but insurer gives a discount

6. Other Insured Rider

    a. Also a term rider added to a whole life policy under certain circumstances
    b. Insured has whole life and wants to add coverage for new spouse
        1. Other insured rider may be utilized
    c. Coverage subject to insurability (physical exam)
    d. Could also be used to add coverage for a newborn child
    e. A parent is allowed to add coverage for a child by adding a child term rider to their own policy (term insurance rider on a child)

7. Long Term Care Rider

    a. A rider that costs extra and may be added to a cash value policy
        1. Which types of life insurance policies this rider may be added to vary by insurance company
    b. The rider allows the insured to take money out of the policy's cash value to pay for qualifying nursing home care or home health care expenses
        1. Any amount used for approved long term care expenses reduces the policy's death benefit
    c. The premium must be paid on the policy to keep this benefit in force
    d. May be subject to a waiting period (sometimes called an elimination period)
        1. Generally 90 days
        2. The waiting period begins when the insured meets the definition for eligibility in the rider

8. Return of Premium Rider

    a. A rider that would cost extra, may be added to term insurance policies depending upon the insurance company
    b. Also called return of premium term (ROPT) insurance
    c. If the insured should live to the end of the term policy period, the premium is returned to the insured tax-free

B. Life Insurance Policy Provisions and Options

1. Entire Contract Clause

    a. Defines what is admissible in court
        1. Only the policy, endorsements and attached papers, if any
            a. Application may be attached, but doesn't have to be
            b. If it is, it becomes part of the entire contract
            c. Most insurers attach application for this reason
        2. Prevents insurers from changing the policy after policy delivery
            a. No changes are valid until approved by company officer
            b. After approval, change must be endorsed to the policy
            c. Producers do not have authority to change the policy
        3. Insured may request a change in the policy
            a. Producer will send change request to the company
            b. Change not effective unless company approves by countersigning the request and endorsing the policy
        4. Protects both the insured and the insurer from unilateral changes in coverage after the policy is issued

2. Insuring Clause or Agreement

    a. States that coverage is provided in accordance with the terms of the policy
    b. Always located on the first page of the policy (the face of the policy)
    c. States the coverage, effective date and parties to the contract
    d. It is the insurance company's promise to pay
    e. It is the insurance company whose promise can be legally enforced

3. Free Look

    a. Enables insured to examine the policy after delivery
    b. Always deliver the policy to your client in person
    c. The insured may return policy and get full refund if not satisfied
        1. Length of free look period varies by state law
    d. If the policy is returned, coverage is voided
    e. If the insured sends the policy back to the insurer or producer, within the time period specified, it is considered returned and all premiums paid will be refunded, no coverage would have ever existed

4. Consideration Clause

    a. Consideration is defined as an exchange of values
        1. Insured pays the first premium and answers questions on the application
            a. Statements made on application are representations
                1. A representation is truth to the best of your knowledge
            b. Warranties are not required on the application
                1. A warranty is a statement you guarantee to be true
        2. The insurer agrees to provide coverage in exchange
    b. Consideration is a prerequisite to a valid contract
        1. No contract exists unless consideration has been exchanged
    c. There is never any coverage unless the premium has been paid

5. Owner's Rights

   a. Must pay the premium
   b. May designate the beneficiary
      1. May change the beneficiary, unless the beneficiary is irrevocable
   c. May take a policy loan or surrender for cash
   d. May assign ownership rights to others, with consent of insurer
   e. May select dividend options and non-forfeiture options

6. Beneficiary Designations

   a. Primary beneficiary receives proceeds when insured dies
      1. Beneficiaries do not sign anything
   b. Contingent beneficiary receives proceeds if the primary beneficiary dies before the insured dies
   c. The estate is considered the final beneficiary
      1. Need not be listed on the policy
      2. Will receive proceeds if no other beneficiary exists
   d. Beneficiary may be any person or entity
      1. Spouse, child or friend
         a. Guardian must be appointed for children
      2. Business partner or a trust
         a. Trusts are sometimes used for estate planning
   e. Generally the beneficiary may be any person the insured chooses
      1. The beneficiary does not need an insurable interest
      2. The exception to this rule would be that in order for the producer who sold a life insurance policy to a client to be able to be named as beneficiary on that policy, insurable interest must be present
         a. It is also true that in order for a producer to be named as beneficiary on a policy the producer must have a contract with the insurer that allows this (contractual agreement)
   f. Most designations are revocable
      1. May be changed at anytime by policy owner
         a. Change must be sent to the insurer for countersignature
      2. If you, as the owner, would like to maintain all of your owner's rights you would want to have a revocable beneficiary
   g. Policy owner may designate irrevocable beneficiary
      1. Beneficiary has vested interest in the policy
      2. Owner may not make changes without their consent
         a. Cannot change beneficiary designation
         b. Cannot take a loan or cash surrender
      3. Sometimes required in divorce settlements
      4. Does not prevent owner from changing a dividend option
   h. Common Disaster Clause (Uniform States Common Disaster Law, Uniform Simultaneous Death Law)
      1. Applies if insured and primary beneficiary both die as a result of the same accident
      2. States that the insured always dies last, even if that is not true
      3. Guarantees that insured's wishes are carried out
         a. Proceeds will go to the insured's contingent beneficiary instead of heirs of the primary beneficiary

4. Most states have a time period in which the primary beneficiary must die in order for this clause to take effect

7. Premium Payment Provisions

   a. Modes of payment
      1. Optional methods of paying premium
      2. Monthly, quarterly, semiannual or annual
      3. The more frequent the mode, the higher the premium
         a. Insurers add service fees for billings
      4. Annual mode of payment has lowest cost
         a. No service fee added
      5. Mode may be changed anytime by the policy owner
   b. Grace periods
      1. First provision to apply if premium is not paid on time
      2. Insured is still covered during the grace period
         a. Insurer will pay claim, but subtract overdue premium from face amount
      3. 30 day grace period for individual life insurance
         a. Whole life or term policies
      4. 31 day grace period for group life
         a. Group life is convertible to whole life during the grace period without a physical exam based on current age
      5. 28 day grace period on industrial life
         a. Sold by debit agents door to door
         b. Small face amount (usually $1,000 or less)
         c. Has cash value
         d. Premium is collected weekly by agent in person
            1. 4 weeks in a month, so 28 day grace period
   c. Automatic premium loan rider (automatic policy loan rider - APL)
      1. An optional rider that must be selected by the insured
      2. Often added to cash value policies to prevent lapses
         a. May not be added to term policies (no cash value)
      3. Usually offered at no extra premium charge
      4. Will automatically borrow the amount of the premium if the insured does not pay by the end for the grace period
         a. Creates a policy loan
            1. Insured has the option of paying the loan back
            2. Unpaid loan will accrue interest if not repaid
      5. Automatic policy loan rider exists to keep whole life policies from going into non-forfeiture
         a. This rider keeps the policy in force
         b. It prevents the policy from lapsing
   d. Level or flexible premium
      1. These policies have level premiums
         a. Ordinary whole life
         b. Limited pay whole life
         c. Single premium whole life
         d. Variable whole life
         e. Equity indexed whole life
         f. Term insurance
            1. Term policies have a fixed premium for the term

2. The term could be one year, or longer than one year depending upon the policy purchased

2. These policies have <u>flexible premiums</u>
    - A. Adjustable whole life
    - b. Universal whole life
    - c. Variable/universal whole life
    - d. Interest sensitive whole life

8. <u>Reinstatement Provision</u>

    - a. <u>Applies when a policy lapses at the end of grace period</u>
    - b. Allows insured to apply for reinstatement for up to five years after a lapse
        - 1. Must <u>pay all back premiums</u> plus interest
        - 2. Must <u>furnish evidence of insurability</u>
        - 3. Must <u>repay all policy loans</u>, plus interest
    - c. If approved, original policy is reinstated
        - 1. <u>Insured maintains original age</u>
    - d. A policy surrendered for cash <u>may not be reinstated</u>
    - e. You do <u>not need to re-establish insurable interest in order to reinstate</u>
        - 1. You only need insurable interest at time of application
    - f. Incontestability clause and suicide clause both start over on reinstatement

9. <u>Policy Loan Provisions</u>

    - a. <u>Apply only to policies with cash value</u> (not term)
    - b. Insurance company will loan its money to the insured
        - 1. Insurer <u>keeps insured's cash value as collateral</u>
        - 2. Loan balance, plus interest, <u>may never exceed collateral</u>
            - a. If it does, <u>policy will lapse</u>
    - c. Insurer normally has its funds invested
        - 1. If loaned out, they lose interest
        - 2. Interest charged to insured to offset this loss
    - d. <u>Maximum fixed interest rate usually 8% annual</u>
        - 1. <u>Interest is charged up front every year</u>
    - e. Interest rate stated in policy may never be changed
        - 1. Older policies may have lower interest rates
    - f. Adjustable (variable) interest rates may be permitted
        - 1. Interest rate is not fixed
    - g. Loans need not be paid back while insured is alive
        - 1. But interest will accrue if loan not repaid
    - h. <u>Loan plus interest subtracted from face amount upon death</u>

10. <u>Non-forfeiture Provisions or Options</u>

    - a. Required by law in all policies that have cash value
    - b. <u>Gives the insured flexibility</u> - may be selected at any time
    - c. Insured's <u>cash value may not be forfeited to the insurer</u>
    - d. Stated in the policy from inception in case policy lapses
    - e. Insured has a choice of <u>3 non-forfeiture options</u>
        - 1. <u>Cash Surrender</u>
            - a. Exchange his policy for full amount of cash value
            - b. No further coverage exists

c. Amount received in excess of premiums paid is taxable

2. Extended Term
   a. Insured exchanges cash value for a new term life policy
   b. New policy has the same face amount as original policy
   c. Does not cover to age 100 - only for a period of time
      1. Policy period depends upon insured's current age and the amount of cash value in the original policy
   d. Provides the most protection - face amount same as old policy
   e. Extended term is also known as the automatic option
      1. Insurer must give insured this option if the insured does not select one of the others when old policy lapses
3. Reduced Paid-up
   a. Insured exchanges cash value for a new whole life policy
      1. Cash value is utilized as a single premium for new policy
      2. New policy is paid up until insured's age 100
         a. No further premiums due
         b. New policy has immediate cash value
         c. Insured may borrow from new policy
         d. Insured may surrender new policy for cash later
         e. New policy issued without a physical exam
   b. Face amount of the new policy will be reduced
      1. Cash value of the old policy not sufficient to buy new policy with same face amount due to current age increase
      2. New face amount will be more than the cash value of old policy, but less than the old policy's face amount
   c. Reduced paid-up will cover the insured the longest
      1. New policy is whole life, paid up to age 100

11. Dividends and Dividend Options

a. Dividends may be paid by a mutual insurance company
   1. Paid to policyholders, since they own the company
   2. May never be guaranteed
      a. But may be projected into the future
      b. Past dividend history may be stated, if accurate
b. Mutual insurers issue participating policies
   1. Policyholders might participate by receiving a dividend
c. Stock insurers issue nonparticipating policies
   1. Policyholders do not participate in dividends
      a. Only stockholders receive a taxable dividend
d. Dividends paid by a mutual insurer are not taxable
   1. IRS has ruled they are merely a return of premium paid
      a. Insured paid initial premium in after tax dollars
e. Mutual insurers offer insured choice of 5 dividend options
   1. Cash
   2. Interest
      a. Insured leaves dividend with insurer
      b. Insurer pays insured interest on the dividend
      c. Dividend is not taxable, but interest is (Form 1099 sent)
   3. Paid-up additions
      a. Insured uses dividend to purchase small paid-up policy

b. Issued regardless of health
c. New policy is whole life, paid up to age 100
d. <u>Allows insured to obtain more insurance, even if sick</u>
e. Most popular dividend option

4. <u>Apply to premium when due</u>
   a. Dividend offsets amount of premium due
   b. Insured just pays the difference
5. <u>One year Term Insurance</u>
   a. Like paid-up additions EXCEPT dividend buys <u>term policy</u>
      1. New, additional Term policy <u>expires in 1 year</u>
      2. Since Term is cheaper, face amount is higher
   b. Selected by insureds who might die this year

f. Dividend options <u>may be changed at any time</u> by policy owner
   1. <u>Even if the policy has an irrevocable beneficiary</u>
      a. Beneficiary has no control over dividends

12. <u>Incontestability Clause</u>

a. Allows insurer to contest a claim <u>during first 2 years</u>
   1. If insured lied about a <u>material fact</u> on application
b. <u>Policy is incontestable after 2 years</u>
   1. All claims must be paid after 2 years, regardless
      a. Even if insurer knows the insured lied
c. This clause protects insurer for first 2 years, protects the insured thereafter
d. Related to the <u>entire contract clause</u>
   1. The application is admissible in court <u>if attached to policy at issue</u>
e. If the insurer accepts an incomplete application
   1. They may be <u>waiving their rights under incontestability</u>
   2. Incomplete applications usually returned for completion

13. <u>Assignments</u>

a. Allows owner to permanently or temporarily assign owner’s rights
b. <u>Absolute assignment is permanent change of ownership</u>
   1. A key person policy may be assigned to the key person at retirement
   2. A child's policy may be assigned to the child at age 18
   3. Old owner is known as the <u>assignor of the policy</u>
   4. New owner is known as the <u>assignee of the policy</u>
      a. New owner assumes all rights of ownership
   5. <u>Assignment not effective until countersigned by insurer</u>
c. <u>Collateral assignment is temporary</u>
   1. Often used when insurance is required as a condition to a loan
   2. Insured executes lien against the policy in favor of a bank
   3. If insured dies, insurer will pay off loan balance
      a. Remaining proceeds go to insured's beneficiary
   4. If insured lives and satisfies loan, lien is released
d. Remember, this is a transfer of the right to change the beneficiary, but in and of itself does <u>not change the beneficiary</u>

14. Suicide Exclusion

    a. A period of time after buying a policy where suicide is not covered
    b. Protects the insurance company against adverse selection
    c. Period of time varies by state
    d. Insurer will generally refund premiums to the beneficiary if the insured dies of suicide before the suicide clause has passed by, less any loans outstanding
        1. Single premium policies have immediate cash values
    e. Suicide is covered, after the suicide clause has passed by, always

15. Misstatement of Age and Gender Clause

    a. Separate from the incontestability clause
    b. Applies indefinitely (not limited to two years)
    c. Protects the insurer when insured lies about their age
        1. States they are younger to get a lower premium
    d. Insurer checks true age upon death
        1. Death certificates must be submitted by beneficiary
    e. If age misstated, benefits (face amount) are adjusted
        1. Beneficiary only receives what the premium the insured paid would have purchased had he told the truth
    f. Premiums are not adjusted, just benefits payable

16. Settlement (Payout) Options

    a. Alternative ways beneficiary may receive proceeds when insured dies
    b. Beneficiary has choice of 5 settlement options
        1. Cash (lump sum) - only payout option that guarantees that the proceeds are not taxable to beneficiary
        2. Interest option
            a. Beneficiary leaves proceeds with insurer to earn interest
                1. Proceeds are not taxable, but interest is (form 1099 sent)
            b. Beneficiary may change option and receive cash anytime
            c. Selected by beneficiaries who want to preserve principal
        3. Fixed amount option
            a. Beneficiary receives fixed dollar amount every month
            b. Proceeds may eventually be exhausted
            c. Unpaid proceeds continue to earn interest (taxable)
                1. Length of time proceeds are paid depends upon earnings
        4. Fixed period option
            a. Beneficiary receives payments for a fixed time
                1. 5, 10, 15 or 20 years (or longer)
                2. Unpaid balance continues to earn interest (taxable)
                3. Proceeds will be exhausted at end of fixed period
                4. Amount of monthly payment depends upon earnings
        5. Annuity option
            a. Beneficiary selects a lifetime payout
            b. Proceeds cannot be exhausted
            c. Payments are made for the life time of the beneficiary
            d. Monthly payments depend upon the age of the beneficiary, the amount of the proceeds and the annuity option selected

17. Accelerated Death Benefits (also known as the Living Benefits Rider)

    a. Apply when insured gets a terminal illness
    b. Insurer will pay out a portion of death benefit to insured
    c. Amount paid out is not a loan (no interest accrues), available even on term
        1. Face amount paid to beneficiary at death is reduced by the amount paid out to the insured while living
    d. Amounts paid out are not taxable
    e. Built in to some policies at no extra premium charge
        1. Added to some policies by means of a rider

C. Life Insurance Policy Exclusions

1. Aviation Exclusion

    a. Added by some insurers if applicant is student pilot
    b. May be removed after insured has specified number of flight hours
    c. Does not exclude coverage while a fare paying passenger
    d. You may pay extra to be covered as a student pilot

2. War or Military

    a. War or Military Service is excluded by most civilian life insurance policies per the contract
    b. People in the service are covered by military term insurance while on active duty

3. Life insurance policies have few exclusions

    a. Most applicants are insurable
    b. Few applicants are rejected
    c. Higher risk applicants are insurable at higher premiums

LIFE SECTION 2
Policy Riders, Provisions, Options and Exclusions

KEY FACTS

- On the GIR, additional amounts of insurance may be purchased without a physical exam only on certain option dates. If the option date is missed, it is lost and cannot be made up.
- When you make an absolute assignment, you are the assignor. The party you assign your policy to is the assignee.
- Insurance companies have 6 months to defer a request for a loan or cash surrender, although they usually do not exercise this right.
- Your policy is the sole collateral for a policy loan. Policy loans may be taken during the grace period.
- Suicide is covered after the suicide clause passes by. If you commit suicide before the suicide clause has passed by, no benefit is payable but all premiums are refunded to the beneficiary.
- An irrevocable beneficiary has a vested interest in the policy (often is an ex-spouse).
- Under the common disaster provision, it is assumed that the insured died last.
- The less frequent the mode of payment, the lower the total annual premium will be, and vice versa.
- There is no service charge or fee if you elect the annual mode of payment.
- On reinstatement, the incontestability and suicide clauses start over.
- The misstatement of age provision runs for the duration of the policy. Discovery of a misstated age results in adjustment of the benefit amount, not cancellation of the policy.
- If the interest option is selected, the interest paid is subject to taxes.
- Proceeds of a life policy left to a beneficiary may not be attached by creditors. If there is no beneficiary, proceeds will go into the estate, which may be attached by creditors.
- A client may exercise the free look provision without giving any reason.
- The free look starts upon policy delivery. If the policy is mailed to the client by the company, the free look starts on the date of mailing. This is called constructive delivery.
- The owner's rights section of a life policy states who has the right to change the beneficiary, who can take a loan, and who can take cash surrender.
- The owners of a mutual insurance company are the policyholders. Dividends received by the owner of a mutual policy are not taxable.
- Dividends received by the owner of stock in a stock company are taxable as ordinary income; dividends are never taxed as capital gains.
- If a beneficiary selects the interest option, interest payments (which are taxable) will vary, but the beneficiary may withdraw the principal at any time.
- The beneficiary does not have to be of the age of majority (18 or 21 depending upon the state) in order to receive policy proceeds. However, minors may not sign releases!

- If a policy with a cash value lapses for nonpayment, the client has 60 days from the premium due date to select a non-forfeiture option. Extended term is the automatic non-forfeiture option.
- Proceeds cannot be directly paid to a minor child since they can't sign a release.
- The GIR allows additional insurance to be purchased without a physical at specified dates.
- A revocable beneficiary may be changed at any time by the policy owner.
- A fixed period payout does not guarantee payments for life of the beneficiary.
- The paid up non-forfeiture option may be taken any time there is a cash value.
- Failure to repay a loan will have a permanent effect on cash value accumulation.
- The entire contract includes the policy and anything else attached at issue, such as application and any riders.
- The accelerated benefits rider will pay out part of the proceeds prior to death. They are not taxable.
- A long term care rider allows the insured to take money out of a policy's cash value to pay for qualifying nursing home care or home health care expenses.
- Any amount used for approved long term care expenses reduces the policy's death benefit.
- When an insured pays extra to include the return of premium rider, if the insured should live to the end of the policy term, the premium is returned to the insured tax-free.
- GIR stands for guaranteed insurability rider.
- The payor benefit rider would expire when the child reaches age 18 or 21, depending upon the state, or when the payor recovers from his/her disability.
- An AD&D rider may be attached to either a term or whole life insurance policy.
- The purpose of the entire contract clause is to protect the insured from the insurer making changes to the policy after issuance.
- The insuring clause is the insurer's legally enforceable promise to pay.
- An insured has lied on an application for life insurance. The policy is incontestable after it has been in force for two years.