

Kansas

Life Insurance Basics

- Learn the process to apply for life insurance
- Determine the type of policy that's best for you
- Get a better understanding of annuities



Kansas Insurance Department
Sandy Praeger, Commissioner of Insurance

Life Insurance Basics



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Dear Kansas consumer,

Only a handful of decisions have great significance over the course of a lifetime. For most people, life insurance falls into that category because it protects a family against a devastating loss of income. This “Life Insurance and Annuity Basics” booklet is designed to provide you with valuable information, as well as address frequent consumer concerns about life insurance and annuities.

Buying a life insurance policy can be a daunting task. The insurance need is usually the greatest when there are young children in the family, only one breadwinner or not enough money set aside to support the survivors for a significant length of time. A consumer must choose from countless options and different types of policies while keeping in mind the legal fine print.

This booklet is designed to assist you in understanding the different types of life insurance products on the market and to answer some of the questions you may have about life insurance. I hope you will find it helpful in assisting you with this important decision and that it will save you time and money by helping you make an informed buying decision.



If you have questions or need assistance understanding life insurance issues or annuities, don't hesitate to contact the Kansas Insurance Department's Consumer Assistance Hotline toll-free at **800-432-2484**. Our trained staff is dedicated to helping answer your insurance questions and finding solutions to your problems.

Sincerely,

Sandy Praeger,
Commissioner of Insurance

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Chapter 1

The basics

Do you need life insurance?

Your need for life insurance will vary with your age and your responsibilities. It is usually the greatest when there are young children in the family, there is only one breadwinner or there isn't enough saved to support the surviving family members for a significant length of time. Life insurance can be an essential part of financial planning.

Most people buy life insurance to replace income that would be lost with the death of a wage earner. The cash provided by life insurance also can help ensure that your dependents are not burdened with significant debt when you die. Life insurance proceeds could mean your dependents won't have to sell assets to pay outstanding bills or taxes. An important feature of life insurance is that income tax isn't payable on proceeds paid to beneficiaries.

Life insurance can be used to help with other financial goals, such as funding retirement or education expenses. However, it is important to remember that the main purpose of life insurance is financial protection. If your primary goals are something other than protection, you should consider other financial products to meet those goals.

Factors to consider

Before buying life insurance, assemble your personal financial information and review your needs. There are a number of factors

to consider when determining how much insurance you should have:

- Any immediate needs at the time of death, such as final illness expenses, burial costs and estate taxes.
- Funds for a readjustment period, to finance a move or to provide time for remaining family members to find a job.
- Ongoing financial needs, such as monthly bills and expenses, day care costs, college tuition or retirement.

Although there is no substitute for a careful evaluation of the amount of coverage needed to meet your needs, one rule of thumb is to buy life insurance that is equal to five to seven times your annual take-home pay.

Basic life insurance plans

All life insurance policies agree to pay an amount of money if you die, but all policies are not the same. Term and whole life insurance are the two most common types of plans, but there are many variations of each type and a number of special-purpose policies that combine the basic policies with other elements.

Term insurance — Term insurance is coverage for a term of one or more years. Benefits will be paid if you die during that period. Some term insurance can be renewed at the end of the “term.” The premium rates usually increase with your age at each renewal.

Whole life insurance — Whole life insurance, also referred to as “straight life,” “ordinary

The primary purpose of life insurance is financial protection.

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life,” or “permanent insurance,” gives lifelong protection if the premiums are paid. Whole life plans have level premiums, which means the premiums do not increase as you age. These policies are designed and priced for you to keep over a long period of time. If you don’t intend to keep the policy for the long term, it could be the wrong type of insurance for you. Whole life insurance policies develop cash values. The cash value is one of the guarantee provisions of your policy. This provision is discussed in Chapter 4.

Universal life — This variation of permanent insurance allows you, after your initial payment, to pay premiums at any time in virtually any amount, subject to certain minimums and maximums. You also can reduce or increase the amount of the death benefit more easily than under a traditional whole life policy.

Universal life may be viewed as a response to consumers who prefer to purchase term insurance at a lower premium cost and invest the difference in some other commodity. The amount of premium not used to purchase your death benefit or pay policy expense charges accumulates as interest in a cash value-type account. The interest rates paid on this money may vary with the market. Unlike a regular whole life policy, surrender

penalties for early withdrawal are common on this type of policy.

Variable life — This type of permanent insurance provides death benefits and cash values that vary with the performance of an underlying portfolio of investments. You can choose to allocate your premiums among a variety of investments that offer varying degrees of risk and reward. You will receive a prospectus in conjunction with the sale of a variable product. The cash value of a variable life policy is not guaranteed, and the policyholder bears the risk.

Extras and riders

You may add other benefits to your life insurance policy at the time of purchase:

Waiver of premium — The waiver of premium rider provides that your policy will stay in force if you become totally disabled. Premiums are



Weighing the differences: Term vs. whole life

Term insurance is often compared to renting your home, and whole life insurance is compared to owning your home. If you own your home, you are building equity in the value of the property. When you sell the property, you retain any cash benefits. If you rent, you pay rent every month but take away nothing when you leave. The same is true of term insurance. With term insurance, you're protected only as long as you pay premiums. With whole life insurance, you accumulate cash values you are entitled to if you cancel the policy.



Premiums for whole life insurance are initially usually higher than term, but they are less than the premiums you would eventually pay if you renewed a term insurance policy for years because a term policy may increase in price each year. Your purpose for buying the policy and how long you intend to keep it should be considered. Term insurance may be better if you're protecting a temporary need. Ask your agent to show you a cost comparison for the length of time you want the insurance.

Term

- Has lower initial premium that increases with age.
- Provides for temporary needs, such as additional insurance during child-rearing period.
- Has no cash value or forfeiture values.

Whole life

- Premium is usually level and remains the same, but it may be higher initially.
- Coverage continues for life or until it is canceled by the insured.
- Provides cash nonforfeiture loan.

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waived as long as your disability continues, and the policy benefits continue just as if you had paid the premiums. You are responsible for notifying the company if you become disabled.

Accidental death benefit — This rider pays an extra benefit if you should die accidentally. Sometimes referred to as double or triple indemnity, the benefit will be two or three times the face amount of the policy.

Guaranteed insurability — This rider guarantees that you will be able to purchase additional life insurance in the future regardless of your health. The policy designates certain times when you will be allowed to add more coverage and not have to answer any questions about your health. The cost for the new policy is based on your current age.

Level-term rider — The level-term rider is temporary coverage that may be attached to a permanent policy to provide extra insurance protection for a specific length of time.

Long-term care rider — The long-term care rider is issued in conjunction with a life insurance policy to help pay expenses if you must reside at a long-term care facility. The benefit for long-term care is usually limited to 50% or less of the total face amount of the policy. The death benefit is then reduced by the amount paid for long-term care.

Accelerated benefit rider — Accelerated benefits, also known as “living benefits,” are payable to you before you die. This benefit allows the policy to pay you all or a portion of your benefit for such things as diagnosis of a terminal illness, the need for an organ

transplant, AIDS treatment, or if you will be permanently confined to a nursing home. The events referred to in the policy as “qualifying events” vary by company. Any benefit paid out before you die will reduce the benefit paid to your beneficiaries when you die. Review the rider to determine what coverage is available.

Life and viatical settlements

Life settlements are the sale on an existing life insurance policy to a third party. A person’s circumstances change, so he or she might want to sell a policy for several reasons, such as divorce, retirement from full-time employment, or the death of a beneficiary.

Viatical settlements are transactions in which insureds with terminal illnesses sell their life insurance policies for a certain percentage of the face value to provide immediate cash. The viatical company may buy the policy and pay the premiums until the death of the insured or may find an investor willing to purchase the policy. The percentage depends largely on the length of time the insured is expected to live. When entering into such an arrangement, consider the following:

- All possible alternatives to the sale of your life insurance contract, including but not limited to accelerated benefits options that may be offered by your present contract.
- Tax consequences may result from entering into a contract to sell your policy.
- Consequences for interruption of public assistance as provided by Medicaid or other public assistance programs.

You have an absolute right to rescind the contract within 30 days of its execution.

Applying for life insurance

There are about 16,000 agents in Kansas licensed to sell life insurance — and that doesn't include agents from outside the state.

You will have to fill out an application for life insurance.

Now that you know about the basic plans of life insurance and you've determined that you are ready to consider a life insurance plan, the next steps are to choose a company and an agent and to complete the application.

Choosing your company

As of the summer 2009, there were more than 560 companies authorized to sell life insurance in Kansas. Make certain the company you're considering is licensed in Kansas. The Kansas Insurance Department reviews companies' financial condition, underwriting practices, claim practices and policy forms.

Choosing your agent

Agents must be licensed in Kansas to sell you a life insurance policy. Approximately 16,000 resident agents are licensed to sell life insurance in Kansas. There are another 35,000 agents from outside the state also licensed to sell life insurance here. Verify the credentials of your agent before making a major purchase.

Life insurance agents do more than just sell policies; they are paid commissions to provide services to their clients. Services you can expect from your agent include:

- Advising you on the right insurance policy to fit your needs. The agent should consider your entire insurance picture before selling you a policy.
- Explaining the cost and coverage of a policy to you.
- Keeping you informed of the latest insurance developments that may be of interest to you.
- Reviewing your insurance with you periodically to consider changes in your financial or family status that may change your insurance requirements.

Completing the application

When you have chosen the policy and amount of insurance you want, the agent or company will have you complete an application,

Chapter 2: Applying for life insurance

which is a questionnaire that asks for personal and medical information and about the type of policy and the amount of coverage you want. The company uses the information on the application as evidence of insurability. Based on this information, the company will determine whether it will issue a policy to you. A copy of the application is attached to the policy when issued and becomes a permanent part of the policy.

It is important that you answer all of the questions on the application as completely and truthfully as you can. A misstatement or omission could make the insurance invalid. If someone has helped you fill out the application, check it for accuracy before signing.

Under no circumstances should you sign a blank or incomplete application.

You will also name your beneficiary on the application. Your beneficiary will receive the insurance money when you die.

Underwriting (qualifying for coverage)

Your life insurance premium is based on the type of insurance and your mortality (risk of death) class. The type of insurance is your choice. Your mortality class, however, is determined by an underwriter using a process through which insurance companies decide whether to accept a risk and in what mortality class the risk should be placed. This is one reason you may find that companies charge different premiums for similar policies.

Your mortality class is determined by such

factors as age, sex, personal and family medical history, habits, residence and occupation. The company's decision to insure your life is based on the application, the medical examination (if required), inspection reports, statements from your physician, special questionnaires, and intercompany data. If the underwriter determines that you are in a substandard class (your risk of death is greater than normal), your policy will be "rated," which means the premium will be costlier than the normal (standard) premium.

Remember, a substandard policy rating is one company's opinion. A different company given the same information may not rate you at all or may give you a lower or higher rating. It is wise to get more than one quote for life insurance.

If you are rated, you should be told the reason (such as health or occupation). If at some later time, the reason for the original rating improves, notify your agent and insurance company and request that they review the situation. Your rating may be reduced or eliminated entirely.

Upon receipt of your policy ...

Review your policy summary. Ask your agent to go over the plan provisions.

You have a minimum 10-day "free look" provision on your policy. If you decide within 10 days of the policy being delivered to you that you do not want it, the company is required by state law to return all of the premiums you have paid. You may return the policy to either your agent or the company to receive your refund.

Chapter 3

Protecting your beneficiaries

Name the beneficiary. Your beneficiary will receive the insurance benefits tax free, and life insurance benefits do not have to go through probate or other legal delays involved in settlement of an estate. If you die without naming a beneficiary, the benefits will be paid into your estate and then paid out according to your will or through state laws. This delays the payment and could create a financial hardship for your beneficiary.

Keep your policy in a safe place. However, do not use any place where the policy might not be readily available. Record the basic information, such as company, policy type, policy number, insured's and beneficiaries' names in a separate place. Let your beneficiary know the kind of insurance policy you have, any changes you make, and where you keep the policy.

A change in beneficiary may be made after the policy is taken out, unless you have named an irrevocable beneficiary. An irrevocable beneficiary arrangement can only be changed with the beneficiary's consent. Your agent can arrange for a change in beneficiaries or you can do it by writing directly to your life insurance company and asking for the appropriate form.

Number of beneficiaries. You can specify as many beneficiaries as you want to receive the benefits. You may also specify how the benefits are to be divided. It is a good idea to name a second (contingent) beneficiary to receive the money in case your primary beneficiary dies before you do.

Social Security and life insurance proceeds for beneficiaries. According to law, monthly life insurance payments will not disqualify the beneficiary from receiving full Social Security payments. Monthly life insurance benefits do not count as earned income, regardless of how much is paid each month through a policy.

Taxes. As a general rule, your beneficiary does not have to pay any federal income taxes on the proceeds of your policy. However, if proceeds of a policy are paid to the deceased person's estate and the total estate exceeds a statutory maximum, including life insurance, there will be federal estate taxes payable. There are variations between states, and tax laws are complex. Your agent has information on the subject, which a lawyer or accountant can explain.

Lost policy. Loss of a life insurance policy will not affect your protection in any way. If a policy is lost, accidentally destroyed or stolen, ask your agent or write the company directly regarding a duplicate.

Filing a life claim. Your beneficiary will need to notify the life insurance company of your death. Again, that's why it is important for your beneficiary to be able to locate your policy. Companies require a copy of a certified death certificate or other legal proof of death and may ask for the policy. The life insurance company will pay the proceeds of the policy to your beneficiary after receiving proper notification of death.

Chapter 4

Important policy provisions

Cash value

Cash value is the amount available when you cancel or “surrender” a permanent policy. Cash values usually begin to build up under your policy during the second policy year after the policy start-up expenses have been paid. This means there may be little or no cash value if you surrender your policy in the early years.

The cash value for a permanent plan of insurance, such as whole life, universal or variable life, comes from the excess premium paid in the policy’s early years. The company invests the excess to provide the basis for the equity or cash value in your policy.

Permanent policies have tables that show the amount of guaranteed cash value. If you have a universal life policy, the insurance company must furnish an annual report that includes the cash surrender value and other pertinent policy information.

Before you surrender your policy for cash, carefully consider the loss of valuable insurance protection you may not be able to get later. Alternatives are available when you need cash or can’t make payments — for example, a policy loan or one of the nonforfeiture options described below.

Policy loans

With permanent life insurance, you may borrow on the cash value of the policy. Unlike loans from most financial institutions, the loan is not dependent on credit checks or other restrictions. The amount of interest payable on the loan is stated in your policy.

You can repay the loan and interest as a lump sum, in installments or not at all. If you do not pay the interest, it is added to the loan. If the unpaid interest added to the loan becomes larger than the cash value, the policy will be terminated without value. Any unpaid loan, including interest, will be deducted from the proceeds at the time of death.

Permanent policies accumulate a cash value, generally beginning in the policy’s second year.

If the unpaid interest added to the loan becomes larger than the cash balance, the policy will be terminated without value.

Chapter 4: Important policy provisions

Nonforfeiture options

Instead of receiving cash if you decide to cancel your policy, you may select one of these nonforfeiture benefits:

Reduced paid-up life. This nonforfeiture option will provide you with a fully paid-up life insurance policy for a smaller amount than the original policy. The cash value in the policy is used to purchase paid-up insurance, which means all required premiums have been paid. This option is useful if you wish to discontinue premium payments (such as at retirement age) and a smaller amount of insurance is satisfactory.

Extended term insurance. The second nonforfeiture option provides that you may use the cash value to purchase term insurance equal to the face amount of the policy. The length of time the term insurance remains in force will depend on the amount of cash value. This option may not be available if your policy is rated.

In either of these options, you are applying the cash value. By law, the value of the life insurance under these options is equal to the cash value at the time the option goes into effect. If either nonforfeiture option goes into effect, all rider coverage (insurance extras) and premiums cease. If your premium has not been paid by the end of the grace period, one of these two options will automatically go into effect. In order to reinstate your policy on a premium-paying basis, you may have to show evidence of good health (insurability).

Dividends and your options. Participating policies may pay the policy owner a dividend

that represents a refund of any excess or unused premium. You may select one of several ways to receive your dividends. Dividends are distributed annually, usually beginning at the end of the second policy year. You may want to review the dividend option from time to time to be sure your dividend dollar is being used to your best advantage.

- **Cash payment.** The dividend is paid directly to you each year in cash.
- **Premium deduction.** The dividend is used to pay part of your premium instead of being paid directly to you. You will receive a notice from the company showing the amount of the dividend and how much premium you have left to pay.
- **Interest option (left on deposit).** You may leave your dividends with the company to earn interest. All or any part of the total amount left on deposit may be withdrawn by you at any time.
- **Dividend addition.** You may use the dividend to purchase additional life insurance on a paid-up basis on the same plan as your regular policy. This is an inexpensive way to buy additional permanent insurance without having to provide evidence of insurability.
- **One-year term option.** You may use the dividend to buy one-year term insurance equal to the cash value of your policy. Substantial additional insurance can be purchased at term rates, but like all term insurance, the coverage is temporary and gets more expensive as you age. Any unused

Chapter 4: Important policy provisions

portion of the dividend may be left on deposit with the company to earn interest.

- **Incontestability provision.** This provision sets a time limit of two years during which the company (with the exception of fraud or nonpayment of premium) can cancel the policy, regardless of any material misstatements which may have been made on the application.
- **Misstatement of age provision.** If the insured dies and the company discovers that the insured's age in the original application was incorrect, the company pays an amount equal to the amount of insurance which the premium would have purchased at the correct age. The amount paid could be more or less than the face amount, depending on whether the insured's age was overstated or understated.
- **Suicide clause.** Companies are permitted to include a suicide provision in their policies. A suicide clause generally states that if the insured dies by suicide during the first two years, the death benefit will be limited to the total premiums paid. After the first two years, the full death benefit is payable in the event of suicide.
- **Settlement options.** At your death the policy proceeds may be paid to your beneficiary in a lump sum; be kept with the insurance company to earn interest; or be paid out in installments in the form of an annuity payment. Your policy will have a table showing the various options available to you and your beneficiary. You may select an option on behalf of your beneficiary or you may wish to let your beneficiary decide

at the time of your death. You should discuss this matter with your agent or company when your policy is issued.

If you stop paying premiums ...

Grace Period. You have a grace period of 30 days after the due date of any premium, meaning your policy will remain in force during that period. If you pay your premium within this period, the protection continues. If you have an automatic premium loan provision in your policy, your cash value will be used to continue your coverage until you resume premiums or until all cash value is used. Companies also have provisions for reinstating policies that lapse through nonpayment of premiums. Generally, they call for presentation of evidence of insurability and for payment of back premiums with interest.

Cash value. This option, previously explained, is available to you if you decide to surrender your policy. However, you must specifically ask for the cash, and there may be a waiting period not to exceed six months.

Automatic premium loan. Some companies offer you the option of automatically paying any overdue premium through an automatic premium loan. It is a policy loan. The advantage of an automatic premium loan is that the policy and riders are kept in force until the cash value is used up even though you fail to pay the premium. However, if you choose this option and then do not want premium payments continued automatically, you must notify the company. Remember, if you continue to pay premiums by this method, you risk having your policy lapse when the cash value is used up.

Chapter 5

Other buying information

Shopping smart

Take your time. Don't rush into a decision just because you are feeling pressured. Make sure you fully understand any policy you are considering and that you are comfortable with the company, agent and product.

Do not pay cash. When you purchase a policy, make your check *payable to the insurance company, not the agent*. Be sure you receive a receipt.

You have a 10-day free look. You have 10 days after you receive the policy to return it to the company and receive a full refund of your premium. You may return it for any reason.

Replacement can be expensive! Canceling a life insurance policy you already have and purchasing a new one is called replacement. Although Kansas law prohibits an agent from making misleading statements or misrepresenting a policy, you still should proceed carefully before replacing an existing policy. Do not replace a policy without fully discussing the proposed change with both your current agent and your company. Never cancel your old policy before a replacement policy is in force.

Important notice regarding replacements

Kansas law requires the agent to give you an "Important Notice" regarding replacement of insurance. This notice should be reviewed when considering replacement. The agent writing the new policy is required to complete a replacement notice, which is sent to your current company to advise them of possible replacement.

Replacement is not always in your best interest for the following reasons:

- The new policy is likely to be at a higher premium because you are older.
- Your new premium must provide for initial "start-up" costs of writing a new insurance policy. This means your cash value "buildup" starts over.
- Kansas law requires that "prior time served" under the old policy should be applied to a new policy. Be sure you get credit and ask about the incontestability provision. If you increase the death benefit on the new policy, you will start a new incontestability period only on the increased amount.
- Existing policies may be more favorable in such areas as settlement options.
- Your present life insurance company can often make the change you want at a lower cost to you.
- It is usually not in your best interest to borrow against the loan value of your policy to obtain the money to buy a new policy.

Guaranty associations

Kansas statutes created the Kansas Life and Health Insurance Guaranty Association, a funding method under which solvent companies absorb the losses of insolvent companies. The guaranty association is a safety net designed to reduce consumer losses if an insurance company becomes bankrupt. The association also works with its members to prevent insurance company insolvency.

Kansas law defines which companies need to be insured, which contracts are eligible for guaranty fund coverage, and the restrictions

and limitations that apply. Claims payable under the guaranty association are subject to benefit maximums. In no event is the guaranty association required to pay more than the amount of the contractual obligation of the insolvent insurance company. For a consumer to be protected by a Kansas guaranty fund, the insurance company must be licensed to do business in the state.

Life or annuity benefits on any one person, regardless of the number of policies, are limited to a maximum of:

- \$300,000 for death benefits.
- \$100,000 in net cash surrender and net cash withdrawal values.
- \$250,000 for allocated individual annuities, beginning Jan. 1, 2010.

An annuity owner is protected \$100,000 for annuity contracts with a given company. If an individual owned three \$100,000 annuities with a company that became insolvent, the guaranty association would cover only \$100,000.

Covered insurance companies are required to attach a disclaimer to their policies to notify insureds of the limits of protection provided in the event the insurer is declared insolvent.

Fraternal benefit societies

Fraternal benefit societies are organized solely for the benefit of members and their beneficiaries. They are nonprofit corporations. Some fraternal organizations offer insurance benefits. Most fraternal organizations that provide insurance benefits are regulated by the Kansas Insurance Department. However, fraternal insurance companies or their policyholders are not covered by the Kansas Life & Health Insurance Guaranty Association. If you have a question about buying a policy offered by your fraternal organization, contact the department.



If you have further questions about life insurance, contact the Kansas Insurance Department's Consumer Assistance Hotline at 800-432-2484.

The Kansas Insurance Department provides general assistance and information only. It does not endorse or recommend any specific company, agent or program.



Kansas Insurance Department

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