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## Types of Variable Life Insurance and Other Related Concepts

### A. Variable Whole Life Insurance

In addition to a guaranteed level fixed premium and a guaranteed **death benefit**, variable whole life offers a variety of investment choices:

- Benefits;
- Tax advantages;
- Features; and
- Tax-free transfers between funds.

One may choose the death benefit option and the premium level, subject to underwriting guidelines and company qualifications. A policy is guaranteed to stay in force provided that one pays the required premium when it is due; the death benefit will never be less than the **face amount** (reduced by any outstanding loans). Usually, the **policyowner** may change the asset allocation of the cash value up to 12 times per year.

### B. Variable Second-to-Die Life Insurance

A variable second-to-die life **insurance policy** allows the **policyowner** to control the composition and diversification of investments within the policy. There are up to 30 investment choices within some second-to-die insurance variable policies and tax-free transfers within investment subaccounts.

A variable second-to-die life insurance policy has access to tax-deferred cash value accumulations. One can withdraw accumulations or arrange tax-free loans against the policy. Loans and withdrawals reduce the cash value of the policy and the **death benefit**. Income tax-free survivor benefits in a variable second-to-die life insurance policy are payable upon death of the second party.

A medical physical examination is required for issuance. Policies on two lives are available for one healthy person, even if other person is unhealthy. The annual cost can be paid by the insured, beneficiaries, or others. Sometimes policies are held in irrevocable life insurance trusts to move the **face amount** of the death benefit out of the estate of the deceased. The following are some other features:

- Available for individual or corporate purchasers;
- Cash value component of other life insurance policies can transfer into single premium variable life insurance policies;
- Medical physical required for issuance;
- Income tax-free survivor benefits;
- Most have no-cost switches between investment subsets; and
- Some offer no-cost daily switches.

Major asset investment categories are available within investment subsets, such as growth, growth and income, balanced, U.S. government and corporate bonds, U.S. government zero-coupon bonds, foreign bonds, high-yield bonds, large capitalization stocks, small capitalization stocks, and index funds.

Some issuing insurance companies offer the same investment choices within their flexible premium variable life, second-to-die variable life, and single premium life insurance policies.

## C. Single Premium Variable Life Insurance

Single premium variable life insurance is generally not tax **deductible**, has tax-deferred growth, and is a tax-free distribution policy. To a certain extent, variable life insurance policies offer a **death benefit** and a future cash value component based on the rate of return performance of the investment choices selected by the client. It is an **insurance policy** that allows one to control the amount of life insurance protection, as well as composition and diversification of the investments within the policy. A single premium variable life insurance policy allows one to control the premium payment and access to funds.

## D. The Workings of Variable Life Insurance

The major difference between the investment portion of variable life and other forms of life insurance is that the insured may select how the funds in the investment portion of the policy are invested. The insured may invest in an array of investment vehicles, such as stocks, bonds, or mutual funds. The catch is that one may only choose from investment vehicles from his or her insurance company's portfolio. Some insurance companies allow a **policyowner** to select investment vehicles managed by other companies.

Some variable life policies allow one to place monies into money market, limited term bond, or fixed rate accounts, then periodically and systematically take the earned interest from these accounts and invest into other choices within the investment subaccounts.

Some variable life policies offer a program in which the investment is split between the fixed and variable accounts. At the end of the term selected, the fixed account grows to the original investment. The variable component of the investment will reflect the growth (if any) of the cash values.

Variable life policies are regulated securities and regulated by both federal and state regulators. Each offered variable life policy is specific to the state in which it is offered. Consequently, the terms and **conditions** of a **contract** offered in one state might not be the same as in a different state.

## E. Variable Life Insurance and Taxes

Variable life blends the protection and tax advantages of modified single premium variable life insurance with choice of a range of tax-deferred investments. Together, these two elements offer a way to

- Help accumulate assets tax-deferred;
- Access those assets, should they be needed; and
- Pass those assets to beneficiaries free of federal and state income taxes.

## 1. Premium Tax

Virtually every state taxes life insurance premiums, commonly at a rate of 2% (though some may fall anywhere between 2% and 3%). In traditional life insurance policies, the company takes this tax into account when determining premiums and does not separately disclose the fact that the state premium taxes are paid. In variable policies, due to the **disclosure** requirements of securities, the premium tax is disclosed when charged.

The following chart compares and contrasts several characteristics of whole life, universal life, and variable life insurance policies:

Whole Life	Universal Life	Variable Life
<b>Death Benefit (DB):</b>		
Fixed/Guaranteed	May or may not provide a fixed DB	Fixed minimum DB
<b>Cash Value (CV):</b>		
Guaranteed	Guarantees a minimum interest rate	No guarantees
<b>Loans:</b>		
Allowed against the <i>entire</i> current CV	Allowed against the <i>entire</i> current CV	Allowed against a <i>percentage</i> of CV
<b>Premium Payment:</b>		
Generally paid in fixed amounts at fixed intervals	Flexible in amount and timing	Generally paid in fixed amounts at fixed intervals
<b>Investment Account</b>		
Assets in the <i>general account</i> of the insurance company	Assets in the <i>general account</i> of the insurance company	Policyowners can select a <i>separate account</i> that meets their investment objectives
<b>Risk to Cash Value</b>		
<i>Insurer</i> assumes investment risk	<i>Insurer</i> assumes investment risk	<i>Policyowner</i> assumes investment risk

## F. Advantages and Disadvantages of Variable Life Insurance

### Advantages:

- The **policyowner** can borrow cash from the policy during his or her lifetime.
- Variable life insurance provides some measure of automatic increases in death benefits that may keep pace with inflation. Death benefits are connected to changes in the underlying value of the assets that are backing the policy. Because the rate of return assumed when setting the guaranteed minimum death benefit is relatively low, death benefits generally should trend upward and provide some measure of inflation protection.
- Switches or transfers between funds are permitted at least once and usually more times per year, usually with no charge. Earnings on the assets underneath the policy cash values will accumulate tax-free or tax-deferred, depending on whether the gains are distributed at death or during the lifetime.

- Variable life insurance is a cash value policy designed to protect a policyowner and the beneficiaries from erosion of death benefit purchasing power due to inflation.

### Disadvantages:

- There is no premium or **face amount** flexibility in a variable life policy.
- Variable life insurance is expensive. Commissions and service fees can amount to a considerable sum, leaving less available to invest.
- Lifetime distributions or withdrawals of cash values are subject to income tax to the extent attributable to gain in the policy.
- Policyowners bear some mortality and expense risks because these policies are current-assumption policies with respect to mortality and expenses.
- The value of the death benefits may fluctuate, depending on the performance of the investment portion of the policy. However, the death benefit can never fall below a defined level.

## G. Suitability

### 1. Appropriate Sales

Variable life insurance is most appropriately sold to people who have a high risk tolerance for investments, because this policy combines death protection with investments in stocks, bonds, and money market mutual funds. Policy values may grow more quickly than with whole life insurance, but the **policyowner** also assumes more risk. If investments do not perform well, both the cash value and **death benefit** may decrease.

### 2. Suitability Checklist

*What are your primary objectives in obtaining life insurance coverage?*

- \_\_\_\_\_ Asset preservation
- \_\_\_\_\_ Debt protection
- \_\_\_\_\_ Death benefit for heirs (liquidity for taxes)
- \_\_\_\_\_ Funeral expenses
- \_\_\_\_\_ Income replacement (major wage earner)
- \_\_\_\_\_ Business continuity
- \_\_\_\_\_ Charitable gifting
- \_\_\_\_\_ Retirement supplement

*Which of the following statements best summarize your financial objectives?*

- \_\_\_\_\_ My goal is to pay a low premium and have **death benefit** protection for a limited time.
- \_\_\_\_\_ I want death benefit protection and access to cash values for life.
- \_\_\_\_\_ I want to be able to access cash values in the future.
- \_\_\_\_\_ I want death benefit and premium guarantees.
- \_\_\_\_\_ I plan to keep this policy in force for at least 15 years.
- \_\_\_\_\_ I am concerned about inflation and want to take steps to reduce its impact on my future finances.
- \_\_\_\_\_ It is important for me to be able to change the underlying investments in my policy.
- \_\_\_\_\_ It is important for me to be able to increase or decrease the policy death benefit.
- \_\_\_\_\_ It is important for me to have some flexibility in premium payment amounts.
- \_\_\_\_\_ I am comfortable with some risk to principal because it offers the best potential for long-term results.

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