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Features and Benefits of Group Life Insurance

One of the primary features of group life insurance is that it is made available to everyone in the group at much more attractive rates than would be available with an individual policy. Insurers are able to offer this advantage because of the [law of large numbers](#). The expectation is that many, many people of differing ages and health [conditions](#) will pass through the group over time. Some members will leave the group before they die, thus terminating their insurance coverage because group life is usually term insurance. New, often younger, members will join the group, generating additional life insurance premiums.

Usually only members of the very smallest groups are required to prove their individual [insurability](#), while members of larger groups often are covered automatically when they become eligible. This is typical, but there are exceptions, so it is important to know exactly how a particular insurer writes group life coverage.

A. Benefit Schedule

A **benefit schedule** is a predetermined statement of the formula under which benefits will be provided. These benefit schedules generally base coverage amounts on five factors.

Duration of Service: This will reward long-term employees and may decrease an employee's incentive to leave the company. Few employees would stay with a company only because of the group coverage, its formula, or the insurance coverage provided to employees under this method.

Occupational Classifications: Uniform amounts of coverage are provided within each classification. The advantage of this type of formula is that it is simple to administer and is somewhat related to the employees' survivors' needs, the employees' ability to pay in the case of a contributory plan, and the employer's assessment of the employees' worth to the business.

Combination of Factors: Perhaps the most common formula will base the amount of insurance on a multiple of the employee's income — from one to three times earnings. Most insurers require a minimum of \$5,000 on each covered employee, or even \$10,000 in the case of small groups. Some insurance companies may require a minimum coverage for the entire group. However, most insurance companies will issue up to \$500,000 or more on any particular life. Group insurers use medical examinations for ultra-large amounts, sometimes establish special reserves, and reinsure at least a portion of the coverage.

Earnings: Proponents of an earnings basis schedule point out that this type of formula benefits survivors by providing an amount equal to a full salary for a limited time after death. Because it is tied to salary, it will tend to increase with inflation. The employees who may be more productive and are consequently paid more are rewarded accordingly. If the plan requires contributions, cost is directly related to the employee's ability to pay.

Flat Benefit: This provides a flat benefit amount for all participants, thus being the easiest formula to administer. This type is a very good choice for large multiple-employer groups providing coverage under collective bargaining agreements.

B. Master Contract

With group life insurance, only one policy is issued. The master **contract** is held by a master **policyowner**, such as the employer.

The **master contract** details the coverage just as any other life **insurance policy** does, but instead of individual policies, employees/insureds receive certificates of insurance as proof of coverage. This certificate provides essential information about who is covered, when the coverage takes effect, how long it lasts, the amount of insurance provided, and claims procedures. Usually these certificates are included in the announcement booklet distributed to the insured at the time a group life insurance plan is installed or during new employee orientation when the employee joins the group.

Because the employer is considered the master policyowner, it is responsible for paying premiums to the insurance company, although the employee may share in the payment of the policy premiums.

When the employer signs the master contract, it will be assured that the insurance company cannot refuse to renew the contract as long as the employer wishes to continue coverage and pays the premiums. However, the insurer has the right to increase the premium rates. According to the master contract, the insurance company also will have the right to cancel the contract if the number of employees falls below a specified number.

There are 4 important clauses in the master contract:

1. **Grace Period:** This period generally lasts for 31 days after the premium is due.
2. **Claims Limitation:** A **death benefit claim** must be made within 1 year of the last premium paid for a deceased employee.
3. **Adjustment in Premiums Clause:** When an employee's age is overstated, the employer will receive a refund. However, if it is understated, there is no change in the employee's coverage, but the employer will be required to make up the difference in premiums.
4. **Incontestability Clause:** The policy is incontestable, unless fraudulent activity is involved.

C. Eligible Employees

Not all employees are necessarily eligible for group life coverage. Rules for eligibility can vary among groups, as long as the rules are neither discriminatory nor unfair to the insurance company. In some cases, only employees who are paid a specified minimum salary are eligible. Very commonly, only full-time employees are eligible, while part-time and seasonal employees are not.

1. Contributory and Noncontributory Plans

When the employer pays the entire premium with no contribution from the employee, the plan is **noncontributory**. When the employer pays all of the premiums, 100% of eligible employees must be included in the plan to prevent discrimination. Discrimination is illegal. Plans that require any premium payment from employees are called **contributory**. In this plan, employees have an option to be covered or not. However, usually at least 65% to 75% (depending on the insurer) of the eligible employees must participate. A high percentage is required to maintain profitability and to avoid **adverse selection**.

2. Conversion Privilege

Some group life insurance plans permit the covered person to convert the group term life insurance coverage to an individual cash value policy if the employee leaves the group. If an employee terminates membership in the insured group, the employee has the right to convert to an individual **whole life** policy *without proving insurability* at a standard rate, based on the individual's attained age. 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, whether or not the **application** for an individual policy was completed. If the master **contract** is terminated, every individual who was insured under the master plan will be given the option to convert to individual permanent insurance of the same face amount.



3. Group Term Life Beneficiary

Each covered employee has absolute freedom to name any **beneficiary**, but some states prohibit naming of the employer as a beneficiary. Otherwise, the employee may change the beneficiary as often as desired.

If the named beneficiary does not survive the insured and there is no secondary beneficiary named, the **death benefit** will be paid to the estate of the covered employee or to a "successive beneficiary" specified in the master **contract**.

In other words, the master contract may give the insurer the option to pay the proceeds to one or more of the following survivors: spouse, parents, children, brothers, sisters, or the estate's executor. If the master contract contains a **facility of payment clause**, it will allow the insurer to pay part of the proceeds to a person who has incurred funeral or last illness expenses for the covered employee.

D. The Working of Group Life Insurance

Planning for the financial consequences of a premature death is an essential part of every financial plan. Generally, the consequences are simply too large to ignore and cannot be totally covered with individual resources. Life insurance protects a family against the risk of the premature death of the breadwinner or spouse. Life insurance planning should consider a family's short- and long-term needs. The starting point for an effective life insurance plan is to identify whether a risk exists and to define the financial impact of a premature death as a specific dollar amount. Several methods are used to quantify this amount.

All group life insurance policies are covered under Code Section 79. This means that they can receive the favorable tax treatment afforded to group term life insurance, assuming that certain requirements are met.

ERISA has many requirements for a group life insurance plan to meet in order to qualify. One is for the plan to be established and maintained in writing. The plan document must provide a procedure of amending the plan, should the occasion arise, and plan documents must provide one or more "named fiduciaries" who administer the plan.

The plan documents must specify the basis on which payments are to be made to and from the plan. The claims review procedure of the plan has the following prerequisites for a group term life policy:

- Benefits must be provided under a policy carried directly or indirectly by the individual's employer.
- The plan's benefits must be offered to a group of employees as compensation for their services.
- The amount of insurance provided to each employee must be computed under a certain formula before an individual selection.
- The plan must provide a specific **death benefit** that meets the definition of the life insurance **contract**.

1. Considering Experience Rating

Experience rating means that premiums and/or dividends in the future are based at least in part on the number of deaths and administrative costs of the specific employer's actual group, rather than by the experience of a larger pool of employers. Experience ratings are usually based on the claims and expense experience of groups of 200 or more employees. Premiums of smaller employers typically will be based on the experience of a large pool of employers covered by similar master contracts.

In a **pooled rate** situation, a uniform rate is applied to all the groups in the pool. Competition for group sales may have some effect on the size of employer that is experience-rated and the amount of the ratings. Group term premiums are recalculated annually and are based on the average age of the group, which is then adjusted for the aggregate experience. This is often called census rating.

Insurance companies renew group term life insurance annually and may adjust premiums up or down, or guarantee an upper limit for a specific period of time. Experience ratings should be considered when the group is large, employees covered in the group are young, and a steady number of young, healthy individuals comes into the plan, all of which lead to below-average claims.

2. Considering Tax Implications

For the first \$50,000 of life insurance coverage provided by the group plan, an employee does not have to report any income. Even though this term insurance protection is income tax-free, an employee must report and pay income tax on the economic benefit for coverage in excess of \$50,000 if the premiums are 100% employer paid.

The amount reportable is computed by multiplying Table I rates by the amount of coverage in excess of \$50,000. Monthly rates are then added to determine the total annual economic benefit received and reportable by the employee. In the event that the policy is a contributory plan, the employee may reduce the reportable amount by

the amount of coverage attributable to premiums paid with after-tax dollars by the employee.

There are tax benefits for those participating in group insurance plans, so the laws regulate exactly what constitutes an eligible "group." One of the most fundamental features is that all members have some kind of relationship in common.

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. This includes group term insurance, in which the premiums that are attributable up to the first \$50,000 of life insurance are not taxable to the employee.

E. Advantages and Disadvantages of Group Life Insurance

Advantages:

- Enables terminated employees, through the conversion privilege, to convert to individual policies without submitting evidence of **insurability**.
- Allows the employer to deduct premiums for the group life **insurance policy**.
- Facilitates the satisfaction of an employer's moral obligation to the dependents of employees.

Disadvantages:

- Group life insurance coverage must be provided for a number of employees. This increases the employer's cost significantly over nondeductible plans that allow the employer to "pick and choose" who will be covered and on what terms.
- By design and formula, group life insurance protection usually ceases or is reduced significantly at retirement.
- The employer's **out-of-pocket costs** can skyrocket if no new employees enter the plan and the amount is due to the annual renewable term aspect of the group life insurance.
- It is temporary and seems to run out or at least is significantly reduced at the very time that it is needed by the **policyowner** or the beneficiaries. This reduction particularly affects wealthy policyowners with high post-retirement living standards.
- It is a welfare benefit plan, so it is subject to certain ERISA limitations and requirements, including certain reporting obligations.
- A group term life plan cannot cover shareholders who are not employees. Who will be covered, the amount of coverage, and the terms and **conditions** of coverage must be nondiscriminatory and in writing.
- Employees have no guarantee that group coverage will be continued by the employer, because a group policy is a contract solely between the employer and the insurer. It therefore may be discontinued or changed with the particular employee's approval.

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