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Term Life Insurance

There are many types of life insurance products available for consumers. Although all life insurance products offer death protection, each type also includes unique features and benefits and is designed to serve different insureds' needs. Life insurance basically comes in two forms. Term insurance pays only a **death benefit** (a specified sum of money to the person or entity designated in the policy) if death occurs within a specified period of time. This is an immediate benefit on the occasion of death and for a certain amount of years after death. Permanent insurance comes with an additional feature that builds tax-deferred savings called cash value.

A. Term Life Policies – Overview

Let's look at term policies: Term life insurance is often called **temporary protection** because coverage lasts only for a specified period of time (the term of the policy). It should be noted that a consumer can buy a term life **insurance policy** that will commit to insure the **policyowner** for their entire life and guarantee the rates (which do increase with age) in advance. Term life insurance is available for set periods of time (such as 3, 5, 10, 15, 25, 30, or even 40 years) during which the premiums are guaranteed not to increase. If the insured dies during the specified timeframe, the policy pays the **death benefit** to the beneficiaries. Unless the policy is renewed or converted before the end of the term, the coverage expires.

It's important to note that most term policies provide for **guaranteed renewability** (no proof of **insurability** required) at the end of each term with future rates guaranteed in advance. Because a term life insurance policy provides only the element of protection with no cash values, it is often referred to as pure death protection. *What does that mean to the beneficiary and the policyowner?*

- 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.
- There is no cash value in the policy.

The advantage of term policies is that they provide the greatest amount of coverage for the lowest premium.

1. Types of Term Policies

Let's look at the three different types of term policies available. Keep in mind that regardless of the type of **death benefit** offered, the premium is level – or remains the same throughout the term of the policy.

First is **level term**. The majority of term life insurance policies in force today are level premium policies. The insurer averages the premiums for the length of the term and overcharges in the earlier years (this is called front-loading), and effectively undercharges in later years. This allows the premium to remain the same throughout the life of the policy without putting the insurer at increased risk. When a term policy is categorized as level, that refers to the **face amount** and premium which both remain the same throughout the **policy period**, unless a cost of living increase automatically increases the face amount during the policy term. Level term policies are available in various term lengths from 3 years to 40 years. With the exception of providing cash values and any benefits related to cash values, such as loans, term policies can and do generally offer all of the options, benefits, and riders available in cash value policies.

Annual renewable term (ART) is the purest form of term coverage. While technically it is a level premium policy, since the term of the policy is only one year, premiums increase every year. The term of the policy is one year, and it is guaranteed to be renewed each year without proof of **insurability** and future rates are guaranteed in advance. The death benefit remains the same, but the premium increases each year as the insured ages and the probability of death increases. ART is a great choice to cover an obligation that is expected to expire within a relatively short period. For example; a business owner has a debt that, according to the loan payment schedule, will be paid off in the next 7 years, but the business owner anticipates that they will be able to pay the debt off sooner. It may be cheaper to buy ART to cover this loan than any other form of insurance.

The second type of term policy is an **increasing term**. Increasing term policies have a level premium, but the **face amount** increases every year of the policy term. The increase is generally a specific amount per year, or a percentage of the original amount. Increasing term policies often are used to fund riders that provide a refund of premium upon death or gradual increases in total coverage, like a "cost of living increase" riders. Often the increasing term insurance product is a rider within another policy that is used to implement a cost of living rider in the main policy.

Finally, there is a **decreasing term** policy.

As you would expect, decreasing term policies feature a level premium, and a **death benefit** that decreases each year of the policy. So why would somebody want to buy a policy that has that feature? The most common use for decreasing term is when the need for protection decreases over time. A good **application** of decreasing term is to cover the outstanding balance of a mortgage if the insured dies prematurely. The amount of coverage decreases each year, but so does the loan balance or debt. When the policy ends, it has fulfilled its purpose. Another application of decreasing term is to account for a projected general decrease in need for life insurance. Since many mortgages are 30 years in length, decreasing term is available in terms of up to 30 years and can be used to approximate a predicted decrease in overall need for life insurance protection.

A decreasing term policy often is convertible, and because there is no death benefit at the end of the term, it is generally not renewable.

B. Nonrenewable Term Life Insurance

Nonrenewable term life provides coverage only for a short time (usually a year) and is pure death-benefit protection. The risk with nonrenewable term life is that your health might deteriorate and you could be unable to get another policy once the term is up.

Premiums also increase as you age. The overwhelming majority of term insurance is guaranteed renewable, which allows the insured to renew their coverage without proof of [insurability](#) into another term of coverage with rates guaranteed in advance.

C. Annual Renewable and Convertible Term

Annual renewable term insurance offers coverage for an extended period, usually 5, 10, or 20 years. The premium increases each year of the [contract](#) and premiums for the duration of the coverage are guaranteed in advance.

Convertible term offers the option to convert to a form of cash value insurance in the future when regular term premiums might become prohibitively expensive.

Convertible term policies usually provide the maximum protection with the smallest amount of cash outlay required. This is sometimes chosen by young people who are unable to afford the higher cost of cash value insurance, need maximum life insurance coverage and want the option of converting to cash value insurance in the future.

D. Selecting a Suitable Solution: Term vs. Permanent

Which product do you recommend to your client? Your client is looking to you for some direction here. If you knew exactly when the client was going to die, it would be easy to tell him or her which product is best (at least from the insurance standpoint).

Term insurance offers maximum protection with a smaller outlay, but as a person gets older the premiums increase. Some planners argue that people can do better with their money in a side investment that will eventually be large enough to offset the steadily increasing term insurance premiums. While from a mathematical perspective, this is true, it is important that the insured is committed to making regular contributions into an investment account. If the [policyowner](#) has not maximized the available qualified retirement plans available to them, such as an IRA or 401(k), they may find it easier to accumulate funds in a tax [deductible](#) retirement account than in a cash value policy.

Permanent policy cash values accumulate on a tax-deferred basis, whereas most investment earnings are taxed each year as they grow. There is also the chance that the investments won't grow as expected.

Check your company's rates and compare the premiums for a permanent policy with that of a term policy for the same [face amount](#) of coverage at age 30. Then look at the price for the same policies at age 60. See how the cost of the term insurance over that time compares with the cost of the permanent insurance, and look at the cash value of the permanent insurance at that age. Which would you rather have been paying for?

The main reason for purchasing life insurance is to provide a [death benefit](#) when it is needed. It may be a matter of using term insurance for temporary needs and permanent insurance for long-term needs. Consider your clients' budget, and be prepared to monitor the plan periodically so you can recommend changes when necessary.

E. Consumer Application

Two young, recently married professionals just purchased and furnished their new home. Their salaries allowed them to qualify for a \$350,000 mortgage. At work, each has a generous 401(k) plan, but now they want to maximize the matching contributions. They each have a car loan and over \$25,000 in educational loans on

which they are making payments. They have no children at this time, but hope to start a family in the next 5 years.

Given the size of their debts, income, mortgage, and tax-favored savings plans at work, term insurance is the most cost-effective life insurance option for these insured.

F. Suitability

1. Appropriate Sales

Term life insurance is primarily suited for investors with short-term life insurance needs (such as 20 years or less) or those with a long-term need but whose budget won't allow for higher premiums.

If the client's major goal is to provide a **death benefit** for heirs, and he or she does not anticipate needing access to policy cash values in less than 20 years, then term insurance may be the best option when combined with other noninsurance investments, because permanent life insurance cash values take a significant amount of time to accumulate.

Even if the client anticipates not needing access to cash values for 20 years or more, if the client is not subject to high income taxes, term insurance may still be the best protection option when combined with other investments because many other investments have lower costs and fees than cash value insurance.

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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