

## INSIDE

■ *Do you need life insurance? Answer this question first.*

■ *Use the How Much Is Enough? worksheet to determine the amount of life insurance coverage you need.*

■ *What type of policy is best for you? Learn the difference between term and cash value insurance.*

■ *Choose a policy that you can afford.*

■ *Learn to recognize the changing insurance needs of your family.*

■ *Get helpful tips on choosing a reliable insurance company and agent.*

Think for a minute—is there anyone who would suffer financially if you died tomorrow? Perhaps your spouse could enter the labor force or continue to provide income from employment. Perhaps your dependents would be eligible for Social Security survivor benefits and income from family investments. But in most young families, buying life insurance is the only way breadwinners can adequately provide for surviving dependents. Life insurance protects your family's financial resources when you die. It is a contract between you and an insurance company requiring the company to pay someone you name—the beneficiary—a certain amount of money when you die.

Unfortunately, consumers often spend more money on life insurance and know less about it than almost any other purchase. This publication will help you think through the life insurance needs of your family and make wiser decisions about spending your life insurance dollar.

**HOW MUCH IS ENOUGH?**

Your reason for buying life insurance will determine the amount you need. Proceeds can cover debts, pay estate taxes, or go to charities. But for most young

families, life insurance protects dependents from financial hardships resulting from a breadwinner's death.

If you are married and childless, your life insurance needs may be minimal. The question to ask is whether your spouse is financially dependent on you.

If you have children, you almost certainly need life insurance. If both you and your spouse are employed, assess each person's life insurance needs. If one spouse is a full-time homemaker, the breadwinner should carry the bulk of the insurance coverage. However, it makes sense to carry insurance on the homemaker to cover such expenses as child care and housekeeping.

The *How Much Is Enough?* worksheet, Pm-1457b, will help you answer the question: "How much money would my dependents need if I died tomorrow?" You may have to adjust the worksheet to fit your own family situation.

**AVOID OVERBUYING**

The worksheet provides just one estimate of the amount of life insurance you need. Your family's spending plan indicates how much you can afford to spend.

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Remember that life insurance premiums are due regularly and should be included as a fixed expense in your spending plan.

Shop for a policy that provides adequate coverage at a price you can afford. Perhaps you can't afford as much death protection as you'd like. There are options. You could provide income for your spouse during a short-term readjustment period or for the remaining years children will be at home. Perhaps your family could reduce its level of living following your death.

Avoid the mistake of buying a policy you cannot afford and then allowing it to lapse.

### RECOGNIZE CHANGING NEEDS

The size of your family, the income-earning potential of other family members, educational goals of children, and your level of assets all affect life insurance needs. As these factors change, you will need to reconsider the adequacy of your life insurance coverage.

If you decide to have children, your life insurance needs will increase. Over time, your total insurance need will probably decrease as assets increase, debts decrease, and children approach adulthood. Whenever there are major changes in your family's financial needs, use the *How Much Is Enough?* worksheet to point out suggested adjustments in your life insurance coverage.

### TYPES OF POLICIES

All life insurance policies pay a specified amount of money to a beneficiary upon the death of the insured. But all policies are not the same.

No matter how fancy the policy title, life insurance can be divided into two types: term insurance and cash value insurance. They differ by their amount of death protection, savings options, periods of coverage, and cost.

### Term insurance

This is pure insurance protection for a set period of time. Death benefits or face value will be paid only if you die while the policy is in force. Since term insurance has no savings or cash value, it provides the largest immediate death protection for your premium dollar. For this reason, it is useful for consumers who need large amounts of coverage for a known period of time—for example, home buyers or parents of young children.

Some term insurance policies are “renewable” for one or more additional terms without further physical examinations. Annual renewable term is the most common form of term insurance. The death benefit stays level. However, **each time** you renew the policy the premium will be higher, because the risk of death increases as you grow older. Most level term policies are not renewable; the consumer must be able to qualify for coverage in order to obtain a new policy. The premium stays level for a specified term—5, 10, or perhaps 20 years. If you have an expectation of continued need for life insurance beyond the term, seek out a “renewable” rather than a “nonrenewable” policy.

“Decreasing” term policies provide coverage that lessens each year the policy is in force. If you expect your needs to decrease (as your children grow up, for example), this coverage might make sense. Premiums usually remain the same for the duration of a decreasing term policy.

Some term policies also are “convertible.” This means that up to a certain age, often 60, you may convert your term policy to a cash value policy regardless of your health status. Premiums for the new policy will be higher than for term insurance.

### Cash value insurance

Cash value insurance provides both insurance protection and a savings feature. For the same level of insurance protection, premiums for cash value policies will be higher compared to term. The added amount you pay is a form of savings. It produces what is known as “cash value,” which you can borrow against at low interest rates or use as collateral for a loan. An outstanding loan would be subtracted from death benefits if you died before the loan was repaid. If you stop paying premiums, the cash surrender value can be taken as cash or used to continue the policy for a lesser face amount or for the same face amount for a specified period of time. Cash value accumulates tax deferred inside the policy. There are three general types of cash value policies: whole life, universal life, and variable life.

### Whole life

This insurance, also known as “straight” or “ordinary” life, provides death protection at a flat premium rate for as long as you live. Once purchased, no further health examinations are required to continue coverage. “Limited payment” policies allow you to pay premiums within a certain period of time, such as 20 years or until age 65. Premiums are higher since they're paid in a shorter period of time than ordinary life policies.

The annual cost of whole life insurance is much higher than for term at the start, but it never increases as the cost of term does. Many current policies produce dividends which may be used to decrease premiums or increase death protection.

### Universal life

This policy is a hybrid of life insurance and a money market fund. It permits the insured to pay premiums at any time, in any amount, subject to certain minimums and maximums. The amount of the death benefit can be reduced or increased;

however, a medical examination usually will be required in order to increase coverage.

### **Variable life**

Variable life policies differ from whole life and universal life chiefly in allowing choices in the way cash value is invested. You may choose among mutual funds or accounts that guarantee interest and principal. There are two kinds of variable life policies. Variable whole life policies have fixed annual premiums, while variable universal life allows flexibility in the amount of premiums paid. Some policies guarantee that death benefits cannot fall below a minimum level. However, the amount of cash value is typically not guaranteed, and could decline if the underlying investment portfolio performs poorly.

## **DECISIONS TO MAKE**

### **Term or cash value**

Your choice between term and cash value insurance should be based on your financial resources and objectives. Once you have determined the amount of life insurance you need, you must decide how much (if any) of the needed protection you want to meet with term and how much (if any) to meet with cash value insurance. For the same amount of protection, term insurance premiums are much lower than cash value premiums for a young person. As age increases, term premiums rise while cash value premiums remain fixed.

Term insurance is often the choice of young families when there is a need for a lot of insurance and budgets are tight. Remember to first determine how much insurance you need, then select the policy type you can afford. All too often, consumers approach this backwards.

They decide how much to buy based on the premium they can afford.

It's hard to make a good "dollar and cents" comparison between the two insurance options since cash value insurance includes a savings component and term insurance does not. To determine a rate of return on the savings component, a price of the protection component must be assumed. In other words, it cannot be said that any one figure is **the** rate of return on the savings component; rather, it can be said that a particular rate of return applies only when a particular price of the protection component is assumed.

The "term or cash value" discussion is interesting but sidesteps the major concern for young families, which is to provide adequate death protection rather than investment returns.

### **Beneficiary**

You must decide who will receive the insurance benefits upon your death. Name a primary beneficiary who is to receive the benefits. Also identify contingent beneficiaries who would receive the benefits if the primary beneficiary were to die before proceeds were distributed. Inform your beneficiaries about the kinds and amounts of life insurance you have and where the policies are kept.

### **Settlement options**

You must choose how the policy's death benefits will be distributed to the beneficiary. There are four options you'll want to discuss with your beneficiary and insurance agent:

1. Benefits can be received in a lump sum.
2. The installment option allows for payment of fixed amounts until benefits are used up, or equal installments for a set period of time.

3. The beneficiary can leave the lump sum with the company and receive interest income.

4. Benefits can be paid to the beneficiary for as long as he or she lives.

### **Policy ownership**

You must decide who will own the life insurance policy. Life insurance proceeds are subject to federal estate tax if the insured is also the owner of the policy or if the insured's estate is the beneficiary. As you develop an estate plan, discuss life insurance policy ownership and beneficiary status with your attorney.

## **COMPARISON SHOP**

Purchase life insurance from a financially strong company. Several independent firms rate insurance companies' financial stability. Reports from *A. M. Best*, *Duff & Phelps*, *Moody's Investors Service*, *Standard & Poor's*, and *Weiss Research* are available in many libraries. Analyze the financial strength of companies using the various rating classification systems. Look for companies with strong ratings from a majority of the rating services.

Always compare similar policies from several companies. If you have access to group insurance through an employer or organization, include these policies in your cost comparison.

State of Iowa regulations require that insurance companies provide consumers with information to understand and evaluate the relative costs of policies. Each policy is assigned index numbers that will allow you to compare the relative costs of two or more similar policies.

Remember these rules when using the indexes:

■ A policy with a small index number is generally a better buy than a comparable policy with a larger index number.

■ Compare index numbers only for the specific policy and the amount of insurance you intend to buy.

Since no one company offers the lowest cost for all types of insurance at all ages and for all amounts of insurance, it is important that you use the indexes in accurate comparisons.

■ Small differences in index numbers could be offset by other policy features or differences in a company's quality of service.

■ Life insurance cost indexes apply to new policies only. Do not use them to determine whether you should drop a policy in favor of a new one. Ask for information from the company that issued the old policy before you take action.

### CHOOSING AN AGENT

All states require that agents be licensed to sell life insurance. In addition, agents who sell variable products must be registered with the National Association of Securities Dealers. Choose a life

insurance agent who is an adviser instead of just a salesperson. Always keep in mind that an agent's income is typically based, in part, on commissions earned from the sale of policies. He or she should be willing to help you decide if you need life insurance in the first place, help you to choose a policy to meet your needs, and help you use cost indexes to compare similar policies. An agent can advise you on insurance changes if there are shifts in your income and responsibilities. A good agent will take the time to explain policy provisions in detail. The initials "C.L.U." (Chartered Life Underwriter) after an agent's name means he or she has passed examinations and met other requirements set by the profession.

### HELP WITH INSURANCE QUESTIONS

If you have questions about life insurance companies doing business in Iowa, contact:

Insurance Division  
Iowa Department of Commerce  
Legal and Consumer Affairs Bureau  
Lucas State Office Building  
Des Moines, Iowa 50319

### FOR MORE INFORMATION

Other titles in this series include the following.

Pm-1452a	<i>Record Keeping</i>
Pm-1452b	<i>Record Keeping Worksheet</i>
Pm-1453a	<i>Communication</i>
Pm-1453b	<i>Talk About Money Worksheet</i>
Pm-1454a	<i>Spending Plans</i>
Pm-1454b	<i>Spending Plans Worksheet</i>
Pm-1455	<i>Income Taxes</i>
Pm-1456	<i>Home Insurance</i>
Pm-1458a	<i>Health Insurance</i>
Pm-1458b	<i>Shopping for Health Insurance/Disability Insurance Worksheet</i>
Pm-1459a	<i>Credit</i>
Pm-1459b	<i>Analyzing Your Debts Worksheet</i>
Pm-1460a	<i>Buying a House</i>
Pm-1460b	<i>What's Your House-buying Power? Worksheet</i>
Pm-1461a	<i>Owning a Car</i>
Pm-1461b	<i>Calculating Your Car Costs Worksheet</i>
Pm-1462a	<i>Saving and Investing</i>
Pm-1462b	<i>Savings Plan Worksheet</i>
Pm-1463	<i>Estate Planning</i>

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File: Economics 3-3 (Insurance)



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Issued in furtherance of Cooperative Extension work, Acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture. Nolan R. Hartwig, interim director, Cooperative Extension Service, Iowa State University of Science and Technology, Ames, Iowa.