Why and How to Buy Life Insurance

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For many people, life insurance is an essential part of financial planning. You may already own some insurance, either through your employer's group plan or through a policy you purchased yourself. Perhaps you think you need more life insurance coverage. Or, if you have no protection, you may be considering the purchase of a policy. This fact sheet can help you:

- decide if you need life insurance.
- decide what type of policy is best for you.
- compare policies for the best buy in protection for your family.
- know how to select a competent insurance agent and a sound company.

Why Life Insurance?

The purpose of life insurance is to provide future financial security for anyone who depends on your income. Usually, dependents are your children and spouse. Less often they can be elderly parents or someone else you support.

A life insurance policy is a contract between you and an insurance company. You promise to make certain payments (premiums) for the policy. In return, the insurance company agrees to pay an amount of money (death benefit) when you die. The person you name in the policy (beneficiary) receives the death benefit.

Review your life insurance protection regularly. The amount of life insurance you need and the people you want to protect change over your lifetime. Getting married, adding a child to the family, divorcing or children leaving home to be on their own are changes affecting your need for life insurance.

Families with dependent children have a great need for life insurance. As children leave home and the family assets increase, most families need less insurance. At retirement, there may be little or no need for life insurance.

The aim of good life insurance planning is to buy an adequate amount of insurance at a price your family can afford. Take the time to understand the basic types of life insurance and determine your own needs before going to an agent. It will pay off in savings on premiums and increased protection for your family.

Who Needs Life Insurance?

Life insurance protects anyone who is dependent on your income or who would be responsible for your debts upon your death. To make a wise insurance choice, you must identify your financial responsibilities and people who depend on your income.

Married couples with children should give priority to life insurance on the primary earner(s). If the family depends on earnings from both parents, both need insurance. You may want to buy insurance for a nonemployed homemaker, but only if the earner has enough coverage. The death of the primary child caregiver may cause a financial burden for the family. You may need to replace child care services with hired help. The purchase of life insurance for this person will protect against this loss.

Married couples without children usually need little or no life insurance if both spouses can support themselves and have a low debt load. For a young spouse, life insurance could provide an education fund to increase his or her earning capacity. An older full-time homemaker may need insurance protection to provide an income for the rest of her life.

Single persons with dependents usually need life insurance. A single parent needs to consider the amount of support for children available from the other parent or family members. The amount of insurance needed will depend on the amount of resources available for the children's future. A single person who supports elderly parents needs insurance to replace the financial support he or she provides.

Single persons without dependents need little or no life insurance. It is a good idea to purchase a policy to cover funeral expenses or a large debt load. You may wish to guarantee your future insurability. Chances of becoming uninsurable are very small for a young person. Money spent on premiums could start a savings or investment plan.

Children do not need life insurance. No one is dependent on a child's income. Agents will try to sell a small policy to cover funeral expenses for a child. A better use of premiums spent on a child's policy is to buy more insurance for the family's adult earners.

How Much Should You Buy?

The amount of life insurance needed is different for every individual. Need depends on income and resources available to dependents.

Estimates will vary depending on each family's future needs. How long will the surviving spouse and/or children need additional income? If one spouse died, would a nonemployed spouse get a job? How much could he or she earn?

The amount of insurance needed is the difference between available resources and future needs of survivors. Resources include assets, potential earnings of the surviving spouse, Social Security payments and other income. The needs of survivors include burial expenses, debts and monthly living expenses.

There are several ways to figure life insurance needs. Using a formula such as six times annual income does not consider a person's debts and assets. It does not consider the survivor's Social Security benefits or employer group insurance. You can estimate life insurance needs by using the worksheet in T-4129, "Life Insurance: How Much Do We Need?"

What Type of Policy Should You Buy?

In addition to providing death benefits, some life insurance policies are investment plans. All policies evolve from two forms of insurance: **term** or **whole** life. **Term** insurance provides pure protection for your dependents and is the cheapest form of insurance. **Whole**, universal and variable life policies add a savings plan to the protection part. These policies cost more because part of your premium is saved or invested for you by the life insurance company. The interest on the savings is tax-deferred and you may borrow against the savings.

Term insurance provides coverage for a specific time or term, usually one to five years. It pays a benefit only if you die during the period covered by the policy. Purchase a policy that is renewable without requiring a medical exam. Term insurance provides the most protection for your dollar because it has no savings element. Premiums rise with age, but paying higher premiums for each term is usually not a problem. Most families' income increases steadily over the years. If you have a policy that is "convertible," you can exchange it for a whole life policy without proof of insurability. However, the company charges a higher premium for this new insurance. Term insurance is useful to parents of young children as well as people who need large amounts of coverage for home mortgage or other debts.

Whole life insurance combines protection with a savings plan. The policy provides protection for your entire life. Premiums and death benefits stay the same for life. This policy will allow you to borrow on the cash value that builds up over the years. Also, if you cancel the policy, you will receive the cash value. Interest paid on cash values averages 2 to 3 percent. This is much lower than what other savings and investments earn.

Universal life insurance provides both protection and a savings plan. However, the face amount, premiums, rate of return and cash value vary according to interest rates tied to the financial market. The savings plan receives a guaranteed minimum interest rate. The rate is usually around 4-4 1/2 percent. The policyholder can make changes in the premiums paid, savings amount and level of protection. Universal life policies may only be available in face amounts of $100,000 or more. Policy costs are less than whole life but higher than term.

Variable life insurance is similar to universal life. The difference is that the policyholder controls the investments made with the premiums and the cash value in the policy. Premiums can remain the same or change. Death benefit and cash value vary depending on investment rate of return. Poor investments will slow the growth of the policy's cash value. Only experienced investors should buy this type of insurance.

Which type of policy is best for you? First, decide whether you want to buy pure protection or protection plus a savings program. Protecting your family from financial hardship upon your death is the primary purpose of a life insurance purchase.

Some people choose a whole or universal life policy for both insurance protection and savings. The higher premiums they pay for "forced savings" will buy a lower death benefit than a term policy. Most families need a large amount of insurance when children are young. For this reason, term insurance provides the largest amount of protection for the least cost.

Consider other ways to save such as payroll savings plans and automatic bank transfers. These ways provide greater flexibility than an insurance premium. If you buy term, your family will receive both the face amount of insurance and your savings at your death. With a whole life policy, your family receives only the listed death benefit, no matter how much you have paid in premiums.

How and Where to Buy?

Too often the first step in buying life insurance is having an agent contact you. A better approach is to prepare before going to an agent. First, estimate how much protection you need. Then, decide which type of policy you want. Next, shop around for the best buy for the premium dollar. Assuming that all companies charge similar rates is a costly mistake. There are large differences in costs among policies.

A common way to buy life insurance is through an agent who sells insurance for one or more companies. Another way is to buy coverage through a group. Group insurance is usually cheaper than an individual policy and may not require a medical exam. Many employers provide some life insurance as a job benefit. Check with your employer to see if you can purchase additional coverage. Group insurance is also available through professional and fraternal organizations.

How to Select an Agent?

Look for an agent who considers your needs rather than pushing one life insurance product. An agent should look for ways to get you the right type and amount of insurance at a reasonable cost. Insurance agents make higher commissions when selling cash value policies than when selling term insurance. Consider this when an agent recommends a policy. Get names of agents from relatives and friends. Ask agents whether they sell insurance full-time and whether they sell for more than one company. Also, ask about the training they received in life insurance planning. A Chartered Life Underwriter (CLU) has completed special training in life insurance.

How to Select a Sound Company?

How do you find out if an insurance company is financially stable? Will the insurance company honor your policy for the many years when your policy is in force? The A.M. Best Company rates the financial strength of insurance companies on a scale from A+ to C. Best's Insurance Reports is available in your local library. Only consider companies with an A+ (superior) or A rating.

Also, make sure the company holds a license to sell insurance in Oklahoma. The Oklahoma State Department of Insurance can help you resolve any problems with an insurance agent or company licensed by the state. (State Department of Insurance, Room 408, Will Rogers Building, Oklahoma City, OK 73152; 405-521-2828)

How to Compare Costs?

It pays to compare policies and companies before buying life insurance. In some cases, you can cut your premium costs by as much as 50 percent. It is wise to ask the agent to provide an interest-adjusted cost index for the policy. Interest-adjusted cost index figures the cost per $1,000 of insurance for similar policies. Compare cost indexes only between policies of the same type, i.e. term with term or universal with universal. The smaller the index number, the lower the cost. Consumer magazines also publish ratings of policies that may prove helpful. When comparing policies of the same type, look at the following:

- **Term** - death benefits, annual premium payments, whether policy is renewable and convertible to another form of insurance, details of disability riders.
- **Whole life** - death benefits, cost (annual premium minus future dividends), guaranteed cash-value growth for the life of the policy, loan rates.
- **Universal life** - interest rates on future investment returns, guaranteed interest rate, premium payments, onetime or first-year fees, management fees, insurance costs, surrender or withdrawal charges, and cash surrender values. If interest rates seem high, make sure the quote is the net rate after payment of management fees.

What to Do?

1. **Know what your life insurance needs are before making a purchase.** Extension publication T-4129, "Life Insurance: How Much Do We Need" will help you estimate your life insurance needs.

2. **Learn about the different types of life insurance.** Decide if you want and can afford a savings plan in your life insurance program.

3. **Shop around and compare costs of policies from several companies licensed in Oklahoma.** Compare premiums, dividends and cost index. Also, compare cash value growth, loan rates, and administrative fees.

4. **Buy only the amount of life insurance you need and can afford.** Avoid family policies covering more than one person.

5. **When you have narrowed your choice to several policies, request a copy of each policy.** Read the policy and ask about anything you do not understand.

6. **Fill in accurate information on the policy application.** Omitting a health condition can cause denial of your application or cancellation of the policy.

7. **Inform family members about the kind and amount of life insurance as well as location of policies.**

8. **Review your life insurance coverage and beneficiaries whenever your family status changes.** It is important to determine if the coverage meets your current needs.

Suggestions for Further Reading

"A Shopper's Guide to the Best Term Policy." *Money*, August 1989, pp. 137-138.

"Choosing the Right Life Insurance Agent." *Black Enterprise*, February 1990, pp. 55-56.

"Don't Gamble With Your Life Insurance." *Money*, July 1991, pp. 117-122.

"Get Your Life Insurance Wholesale and Save Big Bucks." *Money,* December 1989, pp. 189-190.

"Life Insurance After 40." *Changing Times*, May 1989, pp. 65-70.

"Life Insurance That Pays Off While You're Still Around." *Business Week*, July 31, 1989, pp. 100-101.

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