MARBLEHEAD BANK

LIFE INSURANCE

Quick Guide

This Quick Guide was prepared by Truebridge

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EQUAL HOUSING OPPORTUNITY

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If you weren't here tomorrow, would anybody be worse off financially than they are today? Would their lives be seriously interrupted because they didn't have the financial resources to support their current lifestyle? Would they have to move or go to work and put off a major expense, like college tuition? If the answer to any of these questions is yes, then you need life insurance.

IMPORTANT NOTE: Guarantees are based on the claims paying ability of the issuing insurance company.

Basically, then, your life insurance needs are defined by your relationships with other people, especially your spouse and dependants.

Life Insurance Needs – Guiding Philosophies

Single with Dependants

Are you a single parent with children? Are you divorced and feel that your child's other parent cannot or will not provide for your child in the event of your death? Do you have parents who depend on you financially for monthly income? If so, you need life insurance. Your financial professional will be able to ascertain what amount of insurance will be enough to cover the cost of your children's or parents' care and future objectives, such as a college education. Don't rely on the goodwill of others. Life insurance, combined with good estate planning, will ensure that your loved ones have the future income to meet their needs and fulfill their dreams, if you're no longer here.

Single without Dependants

Life insurance isn't just for those of us who are married with children. If you're a single, you can benefit from it, too, because being unmarried doesn't necessarily mean being alone. In all likelihood, your death would have a financial impact on others. As a single person with no dependants you may or may not need a considerable amount of coverage. There are several reasons why it would be a good idea to go ahead and add a life insurance policy to your overall financial plan.

If you have incurred debt you may wish to purchase enough life insurance to cover those debts should the unexpected happen so that your loved ones can pay those debts on your behalf. Another reason you may want to consider a life insurance policy is that no one knows what the future holds. Life insurance purchased today can protect your future insurability. When you're young and healthy, not only is life insurance cheaper, but getting a policy early in life eliminates the risk that later health issues will make you uninsurable. Some people like to use life insurance as a tax free gifting tool to their favorite charity, other family members or their church.

Just because you may be single with no dependants does not mean that you should overlook the importance of purchasing life insurance.

Married with Dependants

If only one spouse is working, make sure you have plenty of life insurance on the working spouse's life. Life insurance on the non-working spouse's life becomes necessary if the surviving family members will suffer financial hardship if the non-working spouse dies. Will there be enough money to provide for day care if necessary? Will you still be able to save for retirement or your child's college education? Your financial professional will be able to determine your insurance needs based on these and other factors.

If both of you are working, make sure you have insurance on both your lives. Have at least enough insurance on each spouse to replace the income that would be lost if either of you died. Remember, it is very costly to raise and educate your children. Once your children are grown and out of the house, your life insurance needs will decrease.

Married without Dependants

If you have a dual income with no children, then life insurance should be considered if you're concerned that either of you would not be able to maintain the same standard of living if one of you should die. If you have one income with no children, make sure you have adequate life insurance on the working spouse's life.

Selecting the right life insurance requires you to master a lot of detail. Start by exploring some of the life insurance myths and misconceptions. You should also understand how Social Security survivor benefits factor into your insurance plans. And you'll want to calculate how much is enough, so that your spouse and dependents will be provided for, but you won't be paying for more life insurance than you need.

There are several types of policies that you should know about. The two main categories are term insurance and cash-value insurance; choosing between them is a matter of deciding whether you just want benefits payable at your death, or you also want to use life insurance as an investment vehicle.

There are three principal types of cash value life insurance:

1. Whole life insurance
2. Universal life insurance
3. Variable universal life insurance

You'll need to understand the differences between these types if you want to use your life insurance as an investment. There are also other types of life insurance, such as single-premium life insurance and packaged products.

Once you've decided on a type of life insurance, it is essential that you understand your policy. This involves reviewing the application and determining policy ownership and your beneficiary, among other things. Generally, it is not a good idea to replace your policy once you've signed up for it, which is why it is so important to make the choice that's right for you.

If you do your homework, shopping for an individual policy does not need to be complicated or confusing. And there are courses of action available to you if you're rated or uninsurable, for example, because of a serious illness or a history of problems with drugs or alcohol.

How Much Is Enough?

Some financial service companies and consumer organizations suggest that you need a face amount of life insurance that equals at least five times your current earnings. Actually, each situation is different, and the amount you need will depend on your particular circumstances. Your financial professional can help you decide how much life insurance you need.

General Considerations

When You're Younger

You need plenty of insurance if you have young children or there are others who depend on you. Your financial professional can help you decide which type of life insurance is right for you. Review the different options presented in this section. You should count on keeping a good deal of insurance on your life until the children finish school or leave home, whichever comes first. After that, your life insurance needs will depend on your unique personal and work situation.

When You're Older

Once you retire, you should have retirement savings, and Social Security, but you should still consider the need for life insurance after you retire, if you fall into one of the following categories:

- **You had children later in life.** It's wise to keep life insurance at least until the child completes school.
- **Your spouse couldn't live on your retirement savings, personal savings, and Social Security**. If you think an additional death benefit will help your spouse if you predecease him or her, keep the life insurance.
- **You have a sizeable net worth.** Life insurance can play an instrumental role in reducing your estate taxes. If you have a sizeable estate in excess of the asset exclusion amount, purchasing life insurance to pay estate taxes may be part of your estate planning in transferring wealth to your children.

Which Type of Policy Should You Own?

Understanding the Language

Life insurance comes in many shapes and forms that each have their own associated costs and fees, but all are structured according to two basic types:

- Term insurance
- Cash value insurance (also known as permanent insurance)

Term Life Insurance

Term life insurance is a one-sided contract with an insurance company. If you die, the company is obligated to pay a death benefit to your beneficiary as long as you have paid the premium that is due for the term of the policy (the stated term may be a year or longer). Like all insurance policies, it is considered a one-sided contract because you are not obligated to continue paying premiums. At the end of the term (the period for which you are insured), you renew your insurance by paying the new, increased premium the company requires. The rates depend on the type of term policy. Your premium dollars are paying for the pure cost of insurance and some policy expenses. The policy will lapse if you don't pay the premium.

But why buy term insurance if you have nothing to show for it at the end of the year? At least with a cash-value policy, you'll accumulate money that you can use in the future. The reason term insurance is an attractive option is that many people need a lot of insurance at low cost.
Term life insurance can be purchased as an individual policy, as group insurance through a professional or fraternal organization, or as a participant in your employer's group plan.

Employer-Sponsored Term Insurance

Your company may provide you with a base of group term life insurance, e.g., one or two times your salary or a flat amount, at no cost to you. The company may allow you to buy additional term insurance, up to five or six times your salary. These group rates are usually competitive and avoid the hassle of physical exams and medical questions if you apply during the initial enrollment period (when you are hired). The insurance is generally renewable until you retire. At retirement, company-provided life insurance is usually eliminated or reduced substantially.

Most employer plans also allow you to purchase life insurance on your dependants, up to a specified maximum. Your dependants are required to designate you as the beneficiary.

IMPORTANT NOTE: When you leave your company before retirement, your employer-sponsored term insurance is terminated. It is not portable as individual term insurance. However, you can usually convert it to a permanent insurance policy (assuming you need it), but the premiums are typically higher than those policies that require medical underwriting, that is, those requiring a blood test and a physical exam.

SUGGESTION: If you are in good health and in the market for a permanent policy, shop around.

IMPORTANT NOTE: If you're planning on leaving your job and you are not eligible for coverage with your new employer, apply for an individual policy before you leave or shortly thereafter. Most company plans will pay your beneficiary a death benefit if you die within 30 or 31 days after employment. The same also applies if you were carrying dependant life insurance for your spouse or children. Some company plans may even keep you on up to six months, so make sure you check with your employer. Avoid gaps in your coverage.

SUGGESTION: Compare the term rates that your company offers with those offered by private insurance carriers and those offered through associations. If you're in good health as you get older, it may be advantageous to buy additional coverage on your own.

Cash Value Life Insurance

In addition to a death benefit, cash value ("permanent") life insurance policies provide you with a vehicle for saving over time. The premiums may be level or variable; the policy may pay dividends; and the amount of savings may vary with the performance of investments that the company makes. It all depends on which type of cash value insurance you purchase.

The following types of cash value insurance are available:

- Whole life insurance
- Universal life insurance
- Variable life insurance
- Variable universal life insurance

Each type of policy works under its own set of goals and serves different objectives. Familiarize yourself with the different life insurance products before making your decisions.

*For further information on costs and fees, consult your financial professional.

Which Type Is Best for You?

If you decide to purchase cash-value life insurance, you must next decide which type of policy is best suited to meet your needs. Four basic types of policies include whole life, universal life, variable life, or variable universal life.

Whole-Life Insurance

Whole life insurance is the most conservative type of policy. It offers lifetime, permanent coverage with level premiums. Premiums that are both fixed and level will be higher than term insurance premiums in the early years. However, the total cumulative cost may be lower if you keep the policy in force for a long time, for example, if you plan on keeping it through retirement. Whole life policies are most appropriate for those who want lifetime coverage, fixed premiums, and fixed death benefits.

Key features of whole life insurance:

- It provides permanent protection.
- The premiums are generally higher than those for other forms of cash-value insurance.
- The policy has a fixed death benefit and fixed premiums, which remain level.
- It includes a savings element. The policy accumulates a guaranteed cash value from which you can borrow. The increase in cash value grows tax-deferred.
- The policyholder has no say in how the savings element is invested by the insurance company; dividends, which are not guaranteed, are based on the overall mortality, expense, and investment experience of the company.
- If you want to increase the amount of insurance you own, you need to apply for a new policy.
- It is suitable for needs that are permanent; when you are considering keeping the insurance throughout your entire life, for example, to replace income that could be lost in your later years.

IMPORTANT NOTE: Single-premium insurance policies issued after June 20, 1988, as well as other policies that allow a fast cash buildup, are known as modified endowment contracts (MECs). If you own one of these policies or are considering buying one, be aware that there are special tax consequences. These include owing income tax on policy loans (up to the amount the policy has earned) and a 10% penalty on loans or withdrawals made before age 59½ in addition to the income tax).

Universal Life Insurance

Universal life insurance offers a flexible death benefit and flexible premiums. Cash value in the policy varies with the market rate of return and generally can be used to pay policy premiums. Universal life is especially attractive to middle-income individuals who want to vary premiums to reflect changing life situations and needs.

Universal life allows you to withdraw money from its cash value (in addition to borrowing); with whole life, you must borrow against the cash value. However, borrowing from life insurance does pose risks, which could negatively impact your policy and your finances. If you let unpaid interest on the loan accumulate or pay it out of the life insurance dividends, you run the risk of the unpaid amount accruing as income, which then must be reported on your income taxes. If you die with the loan outstanding, the death benefit your beneficiaries receive may be decreased. With universal life, you get a statement each year which shows you a month-by-month breakdown of the mortality charges, contract charges, the portion of your premium that goes into your accumulation account, and the amount of interest earned.

Universal life insurance is most appropriate for individuals with changing financial needs, long-term needs, or for individuals willing to give up guarantees in exchange for greater flexibility.

Key features and drawbacks of universal life insurance:

- It is a combination of term insurance plus a savings component.
- There is a guaranteed minimum interest rate and a maximum guaranteed mortality rate.
- It has flexible premium payments (scheduled contributions); the size and frequency of the premium are adjustable.
- The death benefit is flexible; the size of the death benefit can be increased or decreased.
- Loans are available from the policy.
- Risks include being subject to higher premiums and out-of-pocket costs because the policy is not generating enough income to cover the costs of the policy due to fluctuations in the overall economy and interest rates.
- Universal life policies typically cost more than other types of insurance policies because a portion of the premiums goes toward the savings and investment component.
- Premiums for universal life policies may increase if the premiums are too low to cover the costs and fees or if the cash value of the policy declines.

Variable Life

Variable life insurance is similar to whole life insurance in that it has fixed premiums and a minimum guaranteed death benefit. The difference is that you can direct the investments in the policy from a group of investment accounts made available by the insurance company. So, the investment risk is shifted from the insurance company to you, as the policy owner. Variable life policies are most appropriate for individuals who want greater control over how their premium dollars are invested and who are willing to assume greater risk.

Key features of variable life insurance:

- It is permanent.
- It has a fixed premium.
- Performance risk is transferred from the insurance company to the insured; the policyholder determines how the cash-value element is invested.
- There is no guaranteed minimum cash value; the performance of the cash value depends on the individual sub-accounts selected.
- The death benefit varies with investment performance, but cannot be less than the original face amount.
- Loans may be available from the policy.

Variable Universal Life

Variable universal life is a combination of universal life and variable life insurance. It is the most common form of variable life insurance sold. It lets you adjust the insurance premiums and the death benefit. You choose the underlying investments that support your policy. You control all three basic features of your life insurance. This type of insurance is most appropriate for individuals with changing financial needs, long-term needs, and for those willing to give up guarantees in exchange for policy and investment flexibility.

Key features of variable universal life insurance:

- Contains the features of universal life, but the policyholder determines how the savings portion is invested.
- Your cash value is not guaranteed and the fees and administrative expenses are high. So you need a high annual return to make your investment worthwhile.
- If your funds perform well over time, your cash value and death benefit will increase significantly.

Term Life Insurance

Individual Term Insurance Policies

There are several types of individual term life insurance:

Annually Renewable Term (ART)—This is the most common form of term insurance and can be renewed at the end of the term (one year) without evidence of insurability. Rates increase at each renewal as the age of the insured increases. You pay a premium for the "term," which is one year. These policies are generally convertible and renewable to age 70. Once you are insured, the company must pay a death benefit as long as you pay the premium.

Level Term—With this type of term policy, the premium stays level for a specified period. The annual premiums may be initially higher than an annually renewable term policy, but may be lower over the period of time you intend to hold it. Be careful, though: while the premiums during the initial period are generally low, they can jump substantially once the term expires.

IMPORTANT NOTE: If the policy is not convertible and you are in poor health or uninsurable at the end of the 5-, 10-, or 20-year level term period, and you still need insurance, your term insurance premiums may be prohibitively expensive once the level term period expires, and you may not even find a company that will insure you.

Re-entry Term—This type of policy allows you to renew at a "preferred rate," which may be lower than a standard level term policy. To qualify for the policy at the preferred rate, you usually have to fall within the underwriting limitations for height and weight, health, and smoking status; sometimes there are even financial requirements.

IMPORTANT NOTE: While the premium is scheduled to remain level, the insurance company may only guarantee the rate for the first five or ten years, depending on the policy.

Here's the catch: At the end of the level term period, you are required to provide evidence of insurability in order to "re-enter" the policy at the "preferred rate."

> **IMPORTANT NOTE:** While the "re-entry or preferred" rate is very attractive, you will find yourself paying substantially higher rates if you can't re-qualify at the end of the level term period. If you don't like to gamble, make sure the length of the initial level term period equals the amount of time that you intend to keep the insurance.

Decreasing Term—In this type of policy, the face amount of insurance decreases while the premium remains level. Decreasing term policies are most commonly sold as a form of mortgage insurance, whereby your insurance coverage decreases over the life of the mortgage.

> **IMPORTANT NOTE:** Because the insurance decreases while the premium remains level, this type of term insurance tends to be more costly the longer the policy stays in-force. It is generally not recommended.

Narrowing the Playing Field When Searching for Term Insurance

There are several factors to keep in mind as you shop around for the right term life insurance policy:

1. **Comparing policies**. Every policy illustration or "quote" you receive should have a "net payment" index at the end of the illustration. A life insurance illustration is not the actual contract: it is simply a computer-generated sheet that shows both the current and guaranteed schedule of premium payments by age. The "net payment" index is an interest-adjusted formula that allows you to compare term policies among companies. The lower the number, the less expensive the insurance, assuming you keep it over the stated period. The formula is not perfect, but it is an industry standard. Make sure you are comparing quotes of people of the same gender, age, and status (preferred, standard, smoker, non-smoker, etc.).

2. **Renewability**. Make sure the policy issued is renewable for the length of time you'll need insurance. A policy that is issued as "renewable" cannot be canceled if your health should worsen. If you're young and think you'll need the insurance until you retire, don't buy a policy with a term of five or ten years. You may find yourself unable to purchase insurance in the future if your health should deteriorate. If you're thinking of purchasing a "re-entry" term policy, make sure it is renewable after the initial term.

3. **Convertibility.** If you are buying term insurance, particularly when you're young, you may have a need to purchase or "convert" to cash-value insurance as you get older. If your policy is convertible, it means the company will offer you a cash-value policy without further evidence of insurability. Your conversion status is typically the same as the status of your existing policy. Be careful: some companies limit the age for conversion.

> **IMPORTANT NOTE:** Converting your group term insurance to a cash-value policy may not be your best bet. If you're a non-smoker in good health, have your life insurance company, or any life insurance company, issue you a new cash-value policy and underwrite you by fulfilling the medical requirements. You'll usually be eligible for lower rates.

4. **Premiums.** The amount you pay can vary widely from company to company. Term premiums are calculated differently based on the type of policy. Policies may be participating or non-participating. Participating policies earn dividends, which can help you reduce the scheduled premium increases. Non-participating policies do not pay dividends, but their scheduled premiums are projected to be lower than their guaranteed premiums. One way to compare policies is to look at the company's guaranteed premiums, just in case the company needs to increase its scheduled premium or lower its dividend scale. Regardless of the company's experience, you can determine the worst case scenario.

> **SUGGESTION:** Try to buy one term insurance policy to cover all your life insurance needs and keep your costs down.

> **IMPORTANT NOTE:** When comparing policies, make sure there are no riders attached to the policy. You want to compare apples to apples, and riders can be priced differently.

5. Number of policies. Don't think you'll be able to get it cheaper if you buy two individual policies rather than one large policy. First, the larger the face amount, the lower the cost per thousand dollars of life insurance. Companies band their premiums usually between $100,000 and $249,999, $250,000 and $499,999, and upwards. Second, many companies charge a policy fee in addition to the cost of insurance.

Cash Value Insurance

Cash value life insurance can be used as a way to accumulate cash that could be used for specific purposes in the future, such as paying off your mortgage early, funding your child's college education, or funding your retirement. That's because cash value policies have "living benefits" as well as a death benefit. The cash that accumulates is available to you for emergencies and opportunities during your lifetime. This cash accumulation earns a modest return.

Let's take a look at the financial objectives of cash-value insurance:

- **Your need to save.** Most of us plan on being around a long time, so accumulating cash makes sense.
- **Your desire to avoid taxes.** Your savings are tax-deferred, which means you pay no tax until you withdraw your savings. No taxes are due until you pull out more than you put in. If you borrow your funds, you may never have to pay taxes. And, as with all life insurance, the proceeds payable at your death are income-tax free.
- **Your fears that there won't be enough savings to take care of your heirs.** If you die before you have time to save enough money, the insurance company may provide your heirs with a substantial death benefit.

So when it comes to cash value life insurance, make sure you understand what it is, how it works, and whether or not it is the best option for you. Remember, your primary purpose for buying life insurance is to create an immediate estate for your heirs in the event you die prematurely. Your number one priority is making sure the death benefit is substantial enough to cover the needs and desires of those you leave behind.
If you do decide to borrow against your life insurance policy, it is important to understand how that transaction works and the possible risks to your policy and finances:

- It's a loan, and it accrues interest. You can typically borrow up to the accumulated cash value on your permanent life insurance policy. However, if you let unpaid interest accumulate or have it paid out of the life insurance dividends, the unpaid interest could accrue as income and be subject to taxation by the IRS. The loan itself will also increase by the amount of the unpaid interest. If your dividends aren't enough to cover the premium plus the loan and interest payments, you may have to pay more in life insurance premiums.
- It could reduce the benefits to your beneficiaries. If you die with the loan outstanding, the amount will be deducted from your death benefit, which could leave your loved ones without needed funds.

Employer-Sponsored Group Whole and Universal Life Policies

You and your spouse may have the opportunity to purchase permanent (cash value) life insurance as an employee benefit. Before you decide to purchase, consider the following:

- Will you need life insurance when you retire? If you think that you won't have enough income or income-producing assets for your spouse or dependants in the event of your death, or you still have money to save after fully funding your retirement plans, then permanent life insurance may be right for you.
- If you are considering permanent insurance and you are a non-smoker and in good health, compare the group universal life or group whole life policy with a similar policy you could purchase on your own. Insurability is not an issue for you. You may be able to find a policy that offers you a larger death benefit and greater potential cash value for a smaller premium.

SUGGESTION: Your company may be large enough that the insurance company designed the policy with lower expenses. Make sure you do an accurate comparison with an individual policy that you may be considering.

- The dollar amount you can afford will usually buy a relatively low death benefit. The cost of universal life insurance with a specified face amount under $100,000 is relatively high compared with the same policy issued with larger death benefits. The contract charges eat up much of the premium and the actual return on your cash value may be negligible.

> **SUGGESTION:** If you're not putting the maximum contribution into your retirement plans, consider opting for term insurance. Fund your retirement plans first.

Who should consider employer-sponsored products?

If you've been ***rated*** by an insurance company and need a cash-value policy, or you simply don't want to be bothered with many underwriting requirements, you may have a better chance of securing life insurance with employer-sponsored group whole- and universal life.

Whole Life Insurance

Traditional whole life policy, also called ordinary life or straight life, is basically a life insurance policy with a savings component. The premium, which is substantially higher than the premium for term insurance, is level and guaranteed for the life of the policy, which can either be to age 95 or to age 100 (some companies go up to 121 now). The death benefit is also guaranteed by the insurance company.

As you make your premium payments—annually, semiannually, quarterly, or monthly—part of your payment goes towards a guaranteed cash value which offsets the amount of insurance the company is required to pay for in the event of your death. In a sense, you are pre-funding your own death benefit. As the cash value increases each year, the amount of pure insurance in the policy decreases. This way, the insurance company is able to guarantee you a level premium. When you die, assuming the policy is still in force, the company pays you the face amount, which includes the cash value, less any money borrowed from the policy.

Say you have a $100,000 whole life policy. You die in year ten. The cash value is $9,000 and there are no outstanding loans. Your beneficiary gets $100,000. But what if you had borrowed $5,000? Your beneficiary gets $95,000 ($100,000 death benefit minus the $5,000 loan).

The premiums in a whole life policy are "bundled." This means the company determines a fixed premium and does not visibly break out the charges for the cost of mortality, the contract expenses, or the investment assumptions it uses to determine its premiums. The premium, regardless of the company's experience, is fixed.

Whole life policies are sold by mutual life insurance companies and stock life insurance companies. Mutual life insurance companies generally sell participating policies, which are the most popular type. This means that the policyholder shares in the overall experience of the company. The company puts a little cushion in its premium to protect itself against any adverse conditions. As long as the company does well, the policyholder receives a dividend at the end of the year. The dividend is considered a return of the unused portion of the premium. Dividends are usually non-taxable. If you're considering whole life, you're usually better off with a participating policy.

Many top-rated life insurance companies have a strong history of paying increasing dividends. Policyholders can use their dividends in different ways. They can:

- Take the dividend as cash
- Use the dividend to reduce the premium
- Leave the dividend with the insurance company to accumulate at interest
- Use the dividend to buy paid-up additions
- Use the dividend to buy term insurance

The most commonly used dividend selection is buying paid-up additions (PUAs). These are small pieces of additional whole life that have cash value. A $100 dividend may equal $500 or more in death benefit, depending on your age. Over time, paid-up additions increase the total cash value (guaranteed cash value plus paid-up additions) and the actual death benefit.

Paid-up additions are also used as a means to help diminish the premium in the later years of the policy. While premiums are due every year (until the policy matures at age 95 or 100), you may be able to stop your out-of-pocket premium payments at some future point (10 to 15 years) by surrendering paid-up additions and using either part or all of your future dividends. While this can help your overall cash flow, it means you will build up less cash value and your death benefit will not increase substantially.

Limited Payment policies, such as 20 Pay Life or Life Paid-Up at Age 65, are another form of whole life insurance. The premiums are higher than ordinary whole life, and the guaranteed cash value accumulates faster because the premiums are guaranteed to stop earlier than in an ordinary whole life policy.

Advantages of Whole Life over Other Forms of Cash Value Insurance

- The premiums and death benefit are guaranteed. Regardless of changes in the dividend scale, your premiums remain fixed for the life of the policy.
- The fixed-premium and the guaranteed yearly increase in cash value will prevent the policy from lapsing as long as 1) you pay the annual premium and 2) you pay the interest charges on any loans from the policy either out of your pocket or from the increase in cash-value in the policy.
- If you add a Disability Waiver of Premium rider, the policy is said to be "self-completing." The insurance company pays the entire premium and you continue to build cash-value as long as you're considered disabled and not working. If you never went back to work, the company would pay your premium for life. Disability generally has to occur before age 60. In other types of cash-value policies, this waiver may only cover the mortality costs and contract charges.
- Future dividends are based on the overall investment, mortality, and expense experience of the company. In a decreasing interest rate environment, dividends will drop more slowly than policies that are based on current interest rates, since dividends are based on the company's overall investments.

Disadvantages of Whole Life Insurance

- If you want to increase the amount of insurance you own, you need to apply for a new policy.
- The premiums are generally higher than other forms of cash-value life insurance.
- In many policies, borrowing from the policy will reduce your future dividends.
- In many policies, there is no cash value until the third year. The policy is front-loaded with underwriting expenses and sales charges.
- Even when you use your dividends to accumulate at interest or to buy paid-up additions, cash accumulated in the policy may not equal money put in until 10 to 14 years, or more, have passed. If you are using your policy as a "forced savings," this is definitely not a short-term savings plan.

Combined Whole Life and Term

These policies allow you to buy whole life insurance at a lower annual premium than ordinary whole life. The total face amount includes a base whole life policy; the remaining coverage includes term insurance and paid-up additional insurance. The base policy can generally be as little as 25% of the total face amount. Each year, the dividends buy less and less term insurance as more of the dividend buys paid-up additional insurance, replacing the term portion of the policy.

Eventually, the total face amount of the policy includes the base policy and the paid-up additional insurance—a complete whole life package. Making your insurance whole can take anywhere from 15 to 30 years, depending on the initial split between the base amount and term insurance, the age at which you start, and changes in the dividend scale.

> **IMPORTANT NOTE:** Some policies guarantee the entire face amount (total death benefit) for the first 20 years or so, while others may only guarantee the total death benefit in the first year. If the dividend scale drops, you may have to pay more to keep the total term insurance portion in-force or accept a reduced total death benefit.

Interest-Sensitive Whole Life

Also known as excess-interest whole life, these policies are a hybrid between whole life and universal life. The premiums and the death benefit are fixed, like whole life, but the policy doesn't pay dividends. The rate at which the cash value in the policy accumulates depends on the current interest rate, which is variable. It is the excess current interest over the guaranteed interest rate that allows your policy to accumulate at a faster rate than the guaranteed cash value.

What are the advantages of an interest-sensitive policy?

The premiums are slightly lower than ordinary whole life. They appeal to those who like the borrowing features similar to those in a universal life policy. And, if the current interest rates are high enough, future mortality costs and expenses can be paid out of the accumulation account. You have the flexibility to use the accumulation account to pay one or more premium payments.

Universal Life Insurance (UL)

A universal life (UL) policy is like term insurance with a side fund. After mortality and contract expenses are deducted from your monthly contribution, the remainder of your premium goes into an accumulation (savings) account. The accumulation account earns a variable interest rate that is usually guaranteed not to fall below a certain stated interest rate. Like whole life, this accumulation (cash value) account grows tax-deferred.

Unlike a whole life policy, universal life insurance has a flexible premium and an adjustable death benefit. Provided you satisfy evidence of insurability requirements, the company can raise the actual death benefit in the policy, rather than issue you a new policy, assuming you are willing to pay the additional premium. Likewise, it can decrease the face amount of your policy without surrendering a portion of it.

Universal life insurance policies offer two death benefit options. Option 1 pays a straight death benefit, which includes the cash accumulated in your contract. Option 2 offers an increasing death benefit. When you die, your beneficiary gets the death benefit plus the accumulated cash value.

Unlike a whole life policy, the premium is "unbundled." Each year you receive a statement which shows you a month-by-month breakdown of the mortality charges, contract charges, the portion of your premium that goes into your accumulation account, and the amount of interest earned.

IMPORTANT NOTE: The interest rate that is declared is usually tied to an index. The rate is generally better than bank money-market rates. Whatever the current interest rate, remember that you are accumulating interest on the portion of the contributions that goes into the accumulation account. A current interest rate of 7% may only be producing a 3% to 4% internal rate of return on the entire contribution, particularly in the early years of the policy. So don't think of it as a regular bank account. You are still paying for the cost of insurance and administrative charges.

Pulling Out Early Can Cost You a Bundle

Your UL policy keeps track of two separate figures for your cash-value in the policy. One figure is your current accumulation account; the other figure is what you get if you surrender your policy. Your money goes to work for you right away, but if you pull out too soon the company penalizes you, similar to a decreasing back-end sales charge. Depending on the type of UL contract you have, the cash surrender value may not equal the accumulation account until year 20! If you're purchasing a UL policy, make sure you're in it for the long haul.

Sample Universal Life Values*

Years	Cumulative Premium Payments	Accumulation Account	Cash Surrender Value
1	$475	$370	$0
4	$1,900	$1,600	$0
5	$2,375	$2,000	$115
10	$4,750	$4,640	$3,300
15	$7,125	$7,600	$6,800
20	$9,500	$10,900	$10,900

*Assumes a 35-year-old male, non-smoker, $100,000 face amount accumulating at 7.00% interest. The amounts in the table are only provided to demonstrate how cash surrender value can differ from the accumulation account. The numbers are not intended for demonstration of detailed calculation.

The key thing to remember is that it is the current interest rate that drives the policy. Because the premium (scheduled contribution) is flexible, which means you can raise the premium or lower it within specified limits, the rate at which your cash value grows depends on the amount of your premium plus the rate of interest you earn.

If the actual interest rate over the years averages less than your original current interest rate assumption, your policy will accumulate less cash than projected; if interest rates fall substantially, the policy could possibly lapse. Put simply, the amount of the level premium (scheduled contribution) you agreed on in Year 1 did not accumulate enough cash value to offset the yearly increase in mortality costs. In other words, the contract charges ended up eating into the cash value necessary to keep your policy in force. To keep the policy in force, you may have to increase your premiums.

IMPORTANT NOTE: Make sure the level premium in Year 1 is sufficient to meet your policy objectives, whether it is maintaining a level premium throughout the life of the policy, accumulating a certain amount of cash in the policy by a given year, or causing the premium payments to vanish at some future point.

SUGGESTION: Have your insurance agent run a universal life illustration with an assumed interest rate that is 1–2 interest rate points lower than the current interest rate and see how many years the current premiums keep the contract in force. If the illustration shows the policy will now lapse sooner than the time you were planning to hold onto it, consider raising your scheduled contribution (level premium).

IMPORTANT NOTE: Be careful when reviewing a universal life illustration. If you're thinking of purchasing a universal life policy because you'll need insurance during retirement, make sure the illustration is run at least through age 90. You may be looking at an illustration that only goes to age 65. You want to make sure the policy doesn't lapse when you turn age 70. If you start to notice that the cash in the accumulation account has stopped increasing or is beginning to decrease in the later years of the illustration, have the insurance agent run another illustration that goes out to age 90. Another sign that your annual or monthly contributions may not be sufficient is if the guaranteed column lapses in less than 10 years.

These policies look very attractive when interest rates are high. As with other interest-sensitive contracts, policyholders that purchased these contracts when double-digit interest rates were prevalent have either had to raise their annual contributions or extend the number of years to pay premiums.

Advantages of Universal Life over Other Forms of Cash-Value Insurance

- The premiums are truly flexible. If you have sufficient cash-value, you can use money in your accumulation account to pay future mortality costs and contract expenses. In other words, if funds accumulate quickly, you may choose to skip future premium payments.
- If you use the money in your accumulation account to pay future contract expenses, you are not charged "interest" for borrowing from the contract as you are when borrowing from the guaranteed cash-value in a whole life policy to pay the premium. Your death benefit stays intact.
- The "net" interest rate you are charged for borrowing money from the policy is typically lower than a whole life policy. Typically, you are credited interest on the borrowed funds. It's not as much as the current rate, but it lowers your actual borrowing rate.
- The premiums can be substantially lower than those in a whole life policy; the UL policy provides you with more premium possibilities.

Disadvantages of Universal Life over Other Forms of Cash-Value Insurance

- The current mortality charges are not guaranteed. If the company increases the mortality costs, you may have to increase your premiums. If not, the policy may lapse at some future point.
- Likewise, if the current interest rate drops and remains lower than projected, your current schedule of contributions (monthly or annual premium) may not be sufficient to keep the policy in force. Your policy could lapse as money is continually withdrawn from your accumulation (savings) account to pay mortality and contract expenses.

Variable Universal Life Insurance

The most commonly sold form of variable life is variable universal life insurance. It works similarly to universal life except that the cash value accumulation depends on the performance of the underlying investments, or sub-accounts, that you choose, rather than on a current interest rate. Sub-accounts are owned by the policyholder and not tied to the investment portfolio of the life insurance company. The company generally offers you a choice of stock and bond accounts, and a guaranteed* investment account. These types of policies shift the investment burden from the company to you.

IMPORTANT NOTE: This is an investment-oriented product. Your death benefit is based on the performance of the underlying investments. If your investments do poorly, you run the risk that your death benefit will be reduced and the policy could possibly lapse. To protect yourself against this danger, companies offer riders to guarantee the death benefit regardless of investment performance. These riders may substantially add to the cost of what a regular universal life policy would cost.

*Guarantees are made by the claims paying ability of the insurance company.

Advantages of Variable Universal Life over Other Forms of Cash-Value Insurance

- If your funds perform well over the long-term, your cash-value will rise and your death benefit goes up.
- Your death benefit can stay ahead of inflation since it will grow with the increase in cash-value.

Disadvantages of Variable Universal Life over Other Forms of Cash-Value Insurance

- Your cash value is not guaranteed.
- The contract fees and administration expenses are high, and require a high annual return to make your investment worthwhile. If you're considering a short-term bond or fixed-interest account, consider a regular universal life policy.
- If you're not comfortable with investments that have short-term volatility, you may be concerned about the possibility that the value of your cash and death benefit can fall.
- If you're planning to borrow from the cash value like you would in a 401(k) plan, you're similarly reducing your long-term investment performance. Your death benefit may also be negatively impacted.

Which Type Is Best for You?

Deciding which type of life insurance is best for you and your family can be quite confusing. Refer to the summary table below to compare the features and benefits of the different types of life insurance options.

Summary of Key Features of Different Life Insurance Options

Feature	Whole Life	Universal Life	Variable Life	Variable Universal Life
Goal	▪ Lifetime, permanent protection	▪ Combination of term insurance plus savings component	▪ Lifetime, permanent protection (like whole life)	▪ Combination of universal life and variable life ▪ Most common form of variable life insurance
Premium	▪ Level premiums ▪ Generally higher than those for other forms of cash value insurance	▪ Flexible premiums (scheduled contributions) ▪ Size and frequency of premium are adjustable	▪ Fixed premiums	▪ Adjustable premiums and death benefit
Benefit	▪ Fixed death benefit and fixed premiums, which remain level	▪ Flexible death benefit ▪ Size of death benefit can be increased or decreased	▪ Guaranteed death benefit ▪ Death benefit varies with investment performance, but cannot be less than original face amount	▪ If funds perform well over time, cash value and death benefit will increase significantly
Cash value	▪ Includes a "savings" element ▪ Policy accumulates a guaranteed cash value from which you can borrow ▪ Increase in cash value grows tax-deferred	▪ Contains savings component ▪ Cash value varies with market rate of return and generally can be used to pay premiums	▪ No guaranteed minimum cash value ▪ Performance of cash value depends on individual sub-accounts selected	▪ Contains savings component ▪ Cash value is not guaranteed

Feature	Whole Life	Universal Life	Variable Life	Variable Universal Life
Terms	▪ Policyholder has no say in how savings element is invested by insurance company ▪ Dividends, which are not guaranteed, are based on overall mortality, expense, and investment experience of the company	▪ Guaranteed minimum interest rate and maximum guaranteed mortality rate ▪ Get annual statement showing charges, amount in cash value, and interest earned	▪ Performance risk is transferred from insurance company to insured ▪ Policyholder determines how cash value element is invested ▪ Group of investment accounts made available by insurance company	▪ Grants policyholder maximum control over policy ▪ Policyholder determines how savings portion is invested ▪ High fees and administrative expenses necessitate high annual return to make investment worthwhile
Needs served	▪ Best for those who want lifetime coverage (e.g., to replace income that could be lost in later years), fixed premiums, and fixed death benefits	▪ Best for middle-income individuals who want to vary premiums to reflect changing life situations and needs ▪ Also good for individuals willing to exchange guarantees for greater flexibility	▪ Best for individuals who want greater control over how their premium dollars are invested and who are willing to assume greater risk	▪ Best for individuals with changing financial needs, long-term needs, and for those willing to exchange guarantees for policy and investment flexibility
Loans available	▪ Permits loans but must borrow against cash value ▪ To increase amount of insurance owned, need to apply for a new policy	▪ Permits loans in addition to allowing for withdrawal of money from its cash value	▪ Loans may be available	▪ Loans are available

Other Life Insurance Products

IMPORTANT NOTE: Your sub account performance is based on the portion of your premium that goes into your sub account after the insurance company deducts mortality charges, contract, and administrative charges, including taxes and risk guarantees. If the fund returned 6% last year, your real rate of return on your contributions will be considerably less. Typically, agents can illustrate these policies using annual interest assumptions up to 12%. If an insurance agent shows you a variable life illustration, use a more conservative rate.

SUGGESTION: If you're not an investor and conservative by nature, and concerned that your heirs will have the right amount of money when you're no longer here, don't gamble on a variable death benefit. When might you consider this type of policy? After you have fully funded your retirement plans, have a solid base of term insurance, and plan on holding the policy for a very long time, at least 20 years.

IMPORTANT NOTE: Variable Life Insurance must be sold with a prospectus. It is an investment product and comes under the scrutiny of the Securities and Exchange Commission. Make sure that your agent is a registered representative and he or she provides you with a prospectus.

Single-Premium Life Insurance

These are policies in which you pay the entire premium the first year. Your initial deposit (premium), age, smoking, and health status will determine the size of the death benefit that exceeds your initial investment, so that it qualifies as a life insurance contract.

Like other cash-value life insurance policies, your cash accumulates tax-deferred. However, you cannot borrow your money as easily as you can with other cash-value policies. If you're under age 59½, earnings you withdraw are taxed as ordinary income and are subject to a 10% penalty tax, much like an IRA.

IMPORTANT NOTE: Single-premium insurance policies issued after June 20, 1988, as well as other policies that allow a fast cash build-up, are known as modified endowment contracts (MECs). If you own one of these policies or are considering buying one, be aware that there are special tax consequences. These include owing income tax on policy loans (up to the amount the policy has earned) and a 10% penalty on loans or withdrawals made before age 59½ in addition to the income tax).

Packaged Products

Insurance companies have also designed cash value life insurance policies to insure two lives, paying death proceeds on only one life. This can be advantageous since the premium for the two-life policy is substantially lower than the premiums for two separate policies. However, it is important to make sure that insurance is not needed at the death of both individuals.

First-to-Die

This type of life insurance product is designed as either a whole life or universal life policy. The insurance company pays a death benefit on the first insured's death.
Is this kind of policy suitable for you? Again, you may be better off with two separate term insurance policies. However, if you're really inclined to purchase cash value life insurance, it is best suited for a two-earner family where both spouses' earnings are about the same. It can replace the income that is lost upon the death of a working spouse or to pay off the mortgage. Assuming there are dependants, you still have insurance needs to be filled at the death of the second spouse.

A first-to-die policy can also be used as an estate-planning tool as a source to pay taxes at the death of the first spouse if the unlimited marital deduction is not fully used. If you or your spouse is a business owner, first-to-die policies may be used to fund buy-sell agreements and other benefit needs.

Second-to-Die

These unconventional life insurance policies insure two lives and are primarily used for estate planning purposes to help pay estate taxes at the death of the surviving spouse (second-to-die). They are typically either whole or universal life policies and are usually written to insure husband and wife or a parent and child.

This type of policy can be used to cover an estate tax bill, to provide for heirs, or to make a charitable contribution. The premium on a second-to-die policy is generally lower than for separate policies, since the policy is priced based on a joint age, and the insurance company's administrative expenses are less with one policy.

Typically, an irrevocable life insurance trust is set up before the insurance is issued. The trust is the owner and beneficiary of the policy so that the face amount is not included in the insured's taxable estate. ♦