

California Life Insurance Guide

**What California Residents Should Know About
California Life Insurance**

Provided by

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Introduction

If you are going to make a good choice when purchasing life insurance, you need to understand what type of policies are available. If one type of policy does not fit your needs, then ask and find out about other available policies, many of which are described in this brochure. You can research more information on life insurance policies by checking with a licensed life insurance agent or a licensed life insurance company. You can also consult life insurance books that are available in your public library, as well as life insurance information available on the Internet. The California Department of Insurance (CDI) has a toll-free Hotline and Web site that can provide further information and assistance on life insurance. Please see the many ways to contact the CDI on the last page of this brochure.

Defining Your Needs

When you buy life insurance, you want a policy that fits your needs at a reasonable cost. Your first step is to determine how much life insurance you need. Next, you need to decide how much money you can afford to pay. Finally, you must choose the type of policy that meets your coverage goals and fits into your overall financial plan. Once you have completed these steps, you will be able to move ahead and contact several life insurance companies (through an agent or broker) to shop for the right type of policy for you.

There are many reasons for purchasing life insurance, among which are the following:

- Insurance to provide family protection and financial security to surviving family members upon the death of the insured person.
- Insurance to cover a particular need such as paying off a mortgage or other debt upon the insured's death.
- Business insurance to compensate a company on the death of a key employee or to provide a surviving partner the resources to buy out the deceased partner's share of the business.
- Insurance to provide funds to pay estate taxes or other final obligations necessary to settle a deceased person's estate.
- Insurance to provide the funds necessary for the deceased person's burial expenses.

Choosing the Amount

Simply stated, you should elect an amount of life insurance that is determined necessary to meet the needs you are trying to satisfy. To be overinsured can negatively affect your budget and long range financial goals almost to the degree that being underinsured can. While each person must individually assess their responsibilities, life situation and comfort for risk, it is important to be careful to choose an amount of life insurance that reflects your specific circumstances without underinsuring or overinsuring.

Choosing the Type of Life Insurance

There are two basic types of life insurance: term life insurance and cash value life insurance. There are many policy variations on these two types of life insurance.

- **Term Policies** provide life insurance for a specified period of time. These policies provide benefits in the event of death, but they generate no cash value. If you have a limited amount to spend, and only need insurance for a finite period of time, you may be able to get more coverage by buying term insurance than by buying cash value insurance. Keep in mind that the cost of term insurance increases as you get older, which may make it more expensive than cash value insurance in the long run. Today's term policies usually have two sets of premiums -guaranteed maximum premiums and current premiums. Current premiums are usually much lower, but they can be changed by the insurance company. The insurance company cannot increase the current premium above the guaranteed maximum premiums shown in the policy. When you buy term insurance, you need to make a choice as to how long you want the protection. You may renew the policy without a physical examination for the period of years specified in the policy. Some term insurance can be converted to cash value insurance up to a specified age with no physical examination. Premiums for the converted insurance will most likely be higher than the premiums you would be paying for the term insurance.
- **Cash Value Insurance** combines death benefits with an accumulation feature. The buyer of a cash value policy pays more in the early years than for term insurance, but the premium not needed to pay for the cost of the death benefit accumulates at interest. If the policy is surrendered before the insured person dies, there may be a cash value paid to the owner. Make sure the agent/broker provides you with the method by which the cash value is determined and that they obtain this information based on the policy's guaranteed value. As a general rule, it is not a good idea to buy a cash value life insurance policy if you plan to surrender early. If all premiums are paid, cash value insurance usually lasts for the whole life of a person and pays death benefits to the beneficiaries named

in the policy upon the death of the insured. The cash value can be used as loan collateral for borrowing funds at the interest rate specified in the policy. Any outstanding loans are deducted from policy proceeds at death or at policy surrender.

Some of these products may enjoy tax advantages. A policy lapse or surrender may create a taxable event and may generate a Form 1099. Be sure to check with your tax advisor. Some of the most popular types of cash value insurance are described below:

- **Whole Life Insurance** (also known as straight life, ordinary life, and traditional permanent insurance) has guaranteed premiums and death benefits, and a minimum interest rate, which will be credited to the funds accumulated in the policy. On some whole life policies, higher interest rates may be credited to those funds depending on the future performance of the insurance company's investments.
- **Universal Life** differs from whole life insurance in that it allows the policy owner to vary, with limitations, the amount and timing of premium payments and the death benefit. Cash values are accumulated by crediting premium payments and interest to a fund from which deductions are made for expenses and cost of insurance. The rates at which the interest is credited are declared by the company or may be specified in the contract. Like term insurance, universal life insurance policies usually have two sets of premiums—guaranteed maximum premiums and current premiums. Current premiums may be lower, but they can be changed by the insurance company up to the maximum. They also can include a minimum interest guarantee. Because of its flexibility, a universal life policy can also be structured to operate like term insurance.
- **Variable Life** differs from whole life insurance and universal life insurance in that policy owners direct the distribution of their premium payments among several different accounts or funds rather than by the company's choosing. Typical account choices for variable life are common stock, bond, mortgage, and money-market accounts. With this type of policy, the death benefit and cash value benefits vary in relation to the value of the investments underlying the policy. If the value of the account increases, so will the benefits; if the value of the account decreases, so will the benefits, subject to a minimum guarantee. Variable life insurance is more risky to the policy owner than the other forms of cash value insurance, but there is a possibility of greater returns.
- **Variable Universal Life Insurance** combines the flexibility of universal life insurance with the investment account features of variable life insurance.

Availability of Life Insurance

Agents

Most people apply for life insurance through a licensed agent, who may represent one or more companies. If you use an agent, choose carefully. Agents earn a commission on your business. A professional agent will do more for you than just sell you a policy. They should assess your needs, answer your insurance questions, and help you establish your goals. They should advise you and help you update your insurance. If you are considering the purchase of a variable policy, the agent must have an insurance license and a registration with the National Association of Securities Dealers, as variable products usually involve securities.

Group Insurance

Many employers offer life insurance under a group plan and sometimes pay part or all of the premium. A medical exam is usually not required for insurance purchased this way, and the insurance can be less expensive than coverage purchased as an individual. Under California law, group life insurance must be convertible to permanent insurance at the insured's option when the insured's coverage under the group policy terminates. The converted policy will probably be much more expensive than the group insurance. Some employers will allow insurance companies to send agents or enrollers to their premises in order to offer insurance to their employees. Policies offered in this manner are different from group insurance, and you should evaluate the materials shown to you in the same way as if you were considering a purchase of an individual policy through an agent.

Insurance by Mail Order or Through the Internet

Some insurance companies solicit by mail or through the Internet. In most cases, the prospective buyer mails a completed application directly to the company. These methods of purchasing insurance may cost less because you receive little or no personal assistance, but they may also cost more because of the expense involved in mass mailing. Also, both Internet and mail order marketing may not provide a complete range of choices as target marketing often involves offering only one type of policy. Before you buy by mail or through the Internet, consult an expert who can help you determine the best policy for you.

Finding a Good Policy

Guarantees

When shopping for a life insurance policy, you determine the guarantees on premiums, death benefits, expenses, cash value, mortality changes, and cost of insurance. It is critical to get all promised guarantees in writing.

Sales Illustrations

It is likely that an agent will show you one or more life insurance sales illustrations. An illustration consists of a series of numbers indicating how the policy works. The illustration usually shows the guaranteed results under the policy for each year in the future, and the results if all the non-guaranteed items continue at their present level. This will probably not happen as actual results may be better or worse than the non-guaranteed amounts shown in the illustration (but not worse than those that are guaranteed).

Using Indexes

Your chances of finding a good buy on a life insurance policy is better if you use the index numbers that have been developed to aid you in shopping for life insurance. The Buyer's Guide that each insurer is required to provide to a purchaser explains these index numbers in detail. They are good tools to help you compare the merits of similar policies.

Reliability and Stability of Companies

Recently, high-risk investment strategies have threatened the solvency of some companies and thus the safety of policy benefits. Be sure to check out the insurer's industry rating (as provided by independent rating services) before committing your funds. Also, make sure that your life insurance company is licensed to sell insurance in California. Owners and group insurance certificate holders of life insurance policies issued by companies licensed in California may be partially protected in the event of the failure of the insurer by the California Life and Health Insurance Guarantee Association (CLHGA). If you need further information on CLHGA or California Insurance Code Section 1067.02 (c) that explains the monetary protection under CLHGA, then contact the CDI by any of the methods provided on the last page of this brochure.

Information Sources

Additional information about the insurance companies can be found by reading insurance company rating service reports. Five major insurance rating companies grade insurers based on their financial health and ability to pay claims. These companies are as follows: A.M. Best, Standard & Poors, Moody's Investor Service, Duff & Phelps, and Weiss Research. You should check two or three of these services to get a good look at the company's condition. Often times the reference section of local library will carry materials from insurance rating companies. You may contact the CDI for more information on insurance rating organizations.

Are You Considering Changes to Your Life Insurance Policy?

Many consumers are approached by life insurance agents or life sales representatives and are asked to consider canceling their current life insurance policy in order to purchase a replacement policy. In most cases, the cash value of the current life policy is used to buy more insurance or a new policy. While a decision to replace an existing life insurance policy may be a good one, sometimes this may not be in your best interest. More than likely you purchased your policy with a long term financial plan in mind. Replacing or changing your insurance policy at this point may affect the intended results of your overall financial plan. If you are considering replacing or changing your life insurance policy, you should first assess your needs and determine what is in your own long term best interest. It is also important to consider the interests of those you are protecting. Deciding how much insurance you need, how long it is needed, and which policy provides the best coverage is crucial to your financial security.

Your financial needs should be thoroughly evaluated before changes are made in existing policies. Any change in your personal circumstances since you first purchased life insurance may require a different strategy. A comprehensive evaluation may indicate that replacing or changing your policy is in fact advisable. However, certain cautions are appropriate when considering replacing or changing your life insurance. For example:

- You may have to pay "start up" costs again.
- You may be required to wait one or two years before a new policy passes through the contestable period. During the contestable period the insurer is contractually entitled to cancel the policy or refuse to pay a claim based on mistaken or untrue statements in your application.
- You may pay a higher premium for new insurance over the duration of the policy because you are older than when you first purchased life insurance.
- The financial strength of a new insurer may be different from that of your present insurer.

- There may be specific tax consequences when you replace or change your current policy.
- You may find different loan provisions in a new policy, or you may find that you cannot take tax advantaged loans in the new policy.
- If you use the cash value of one policy to pay for the premium on a new policy, the values used may not be sufficient to support the new policy in future years, and may result in the need to make additional premium payments to keep the insurance in force.
- You may not have immediate access to your money in a new policy. You may have to wait a considerable period of time, or pay a monetary penalty, to access the cash value in the policy.
- Tax consequences may occur if you take cash from an annuity or mutual fund that started as a replacement policy for your original life insurance policy.
- When considering policy replacement, it is important to note that you may have the ability to amend or convert your current policy to a newer product within the same insurance company without any loss of rights or accumulated cash value. It may be in your best interest to contact your current agent or company and to inform them of your intent.

Illustrations are utilized by agents to highlight certain features of their policies. Illustrations should never be the only factor used in deciding to replace or change your policy. Illustrations that are presented for comparison purposes may not give a complete picture of the new policy's future. To insure that your insurance policy meets your financial objectives, it is recommended that you obtain a second opinion, as well as consult with your current agent. Given the complexities involved in counseling a consumer regarding insurance purchases, you may want to inquire about your current agent's and new agent's professional qualifications.

The California Insurance Code and Code of Regulations imposes specific requirements which must be adhered to by agents and insurers when a life insurance po

4. An agent or insurer may not recommend replacement or certain changes to a policy using materially inaccurate presentations or comparisons of policy premiums, benefits, or dividends, if any.
5. Agents and insurers must deliver a copy of the "Life Insurance Buyers Guide" and a copy of a policy summary to all those purchasing life insurance. This required information must be provided no later than when the policy is delivered.
6. If you have second thoughts about purchasing a life insurance policy, the law provides for a free look period of ten days or more. Senior citizens must be given a free look period of no less than thirty days. Discuss the free look period with your agent or insurer before purchasing a life insurance policy.

Beware of Any Agent Who

1. Suggests that using the cash value from your current policy to fund the premiums on a new policy offers a demonstrable advantage to you,
2. Advises you not to speak to anyone from your current insurer about a policy replacement or change he/she is proposing,
3. Asks you to sign incomplete or blank forms, or
4. Speaks negatively about another agent or company.

Your best defense against an ill-advised replacement or change to your life insurance policy is knowledge. The more you know and understand about your current policy and the proposed new policy, as well as the company and the representative, the better equipped you will be to make the best decision. Remember, if you intend to replace or change an existing coverage, you should be sure that the agent selling the new policy has your best interests at heart, and bases the purchase recommendation on an appropriate needs analysis. Agents have a duty to inquire about your current coverage. Once on notice, the regulatory steps designed to protect you should occur.

The information provided in this pamphlet is not a complete listing of questions or effects of an intended replacement of your life insurance policy.

The Department of Insurance cannot make recommendations concerning life insurance products. However, you may always call our Hotline or write to us with any questions. Please refer to the CDI contact information on the last page of this brochure.

This brochure is the result of a joint effort among consumers, insurers, agents, and the staff of the California Department of Insurance. It is intended to address some of the more common issues faced by consumers when making life insurance decisions. However, it does not address all the issues which may affect someone intending to purchase, replace, or change a life insurance policy.

Glossary of Life Insurance Terms

Accelerated Benefit Provision – A provision in many new policies which will allow the policy owner to receive a portion of the death benefit early if the insured person is diagnosed with a terminal illness or permanently confined to a nursing home.

Accidental Death Benefit – A rider added to a policy that provides an additional benefit if the insured dies from accidental causes.

Certificate – A document provided to a person insured under a group insurance policy that provides evidence that the coverage exists.

Evidence of Insurability – Medical and other information about a person applying for insurance that the life insurance company keeps confidential, but uses to decide whether the policy can be issued and what premiums will be charged.

Face Amount – The amount to be paid to the beneficiary when the insured dies. It will be reduced by any unpaid policy loans and interest on those loans, and may be increased by any dividends.

Free Look – The right of the policyowner to have a period of ten or more days to examine an insurance policy, and if not satisfied, return it to the company for a full refund of all amounts paid.

Grace Period – A period of time (usually 31 days) after the premium due date when an overdue premium may be paid without penalty. The policy remains in force throughout the period.

Guaranteed Insurability – An option that permits the policyholder to buy additional stated amounts of life insurance at certain times in the future, without having to provide new evidence of insurability.

Illustration – A document used in life insurance sales presentations showing year-by-year numbers indicating how a policy will work. Usually it assumes that amounts being paid today will continue in all future years.

Insured – The person whose life is covered by a life insurance policy; the policyowner; the policyholder.

Lapse – The discontinuation of insurance without cash value when the required premium is not paid. If cash value exists, there may be nonforfeiture provisions available.

Loan Value – The amount which can be borrowed by the policyowner from the company using the value of the policy as collateral. Usually the interest rate payable on the loan varies based on an index defined in the policy.

Mode of Premium Payment – The frequency of premium payments during the policy year. Premium payments can usually be made on annual, semi-annual, quarterly, or monthly mode.

Mortality Table – A statistical table showing the death rate (probability of death) for each age.

Nonforfeiture Options – A provision in the policy that allows the policyowner to choose how the cash value of the policy will be used if the policy is surrendered or lapses due to nonpayment of premium.

Ownership – All rights, benefits, and privileges under a policy controlled by the owner, who is usually the insured. Ownership may be transferred or assigned to someone else by written request of the current owner.

Paid-Up Insurance – A life insurance policy where all premiums have already been paid, with no further premium payment due.

Participating Insurance – Insurance on which the policyowner is entitled to share in the surplus earnings of the company through dividends, which reflect the difference between the premium charged and the actual earnings and costs of providing coverage.

Policy – The printed document issued to the policyowner by the company stating the terms of the insurance contract.

Policy Year – A one-year period starting on the day and the month the policy was issued. The first policy year starts on the date of issue, and ends on the day before the policy's first anniversary date.

Premium – The payment a policyowner is required to make to an insurance company to purchase insurance coverage and to keep the policy in force.

Rated Policy – A policy issued with an additional premium to cover the extra risk involved if an insured has impaired health, a hazardous occupation or hobby, or is a private pilot.

Reinstatement – The restoring of a lapsed or surrendered policy to full force and effect. The company requires evidence of insurability and payment of all amounts necessary, including interest, to put the policy into the condition it would have been in had the lapse or surrender not occurred. The company is not obligated to reinstate a policy.

Rider – A provision added to a policy that provides additional benefits, usually accompanied by a corresponding premium increase or change.

Settlement Option – The manner in which the insured or beneficiary may choose to have the policy proceeds paid.

Suicide Clause – A policy provision which reduces or eliminates the amount to be paid if the insured dies from suicide within the first two policy years.

Standard Risk – The classification of an applicant for a life insurance policy who fulfills the physical, occupational, and other requirements on which most of the company's policies are issued. Someone whose characteristics are more favorable may be classified as a "Preferred Risk." When the characteristics are less favorable, the applicant may be characterized as "Rated" or refused coverage altogether.

Surrender – To voluntarily terminate or cancel a policy for its cash value or other nonforfeiture options.

Underwriting – The process of evaluating applicants for insurance and classifying them fairly, so the appropriate premium rate may be charged. This may involve a physical examination of the applicant.

Waiver of Premium – A rider added to policy that will waive the premium payments required by an insured during the total disability of the insured.