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Life Definitions

Life Insurance has been transacted in the United States since the mid-1700s. The life insurance business began to have significant growth in the mid-1800s due to the agency distribution system. Studies show that less than 50% of Americans own individual life insurance.

The chief function of life insurance is to ***create an estate***. When an insured dies, a definite sum of money will be paid to the beneficiary. **The money may:** *meet current obligations of the survivors such as funeral costs and medical bills, pay for future expenses such as a college education, serve as continuing income for the spouse, or support other needs of a beneficiary.* ***Life insurance is protection for the consumer***.

The obligations and expenses listed above are ***death benefits***. Life insurance does provide **living benefits** as well. These benefits usually are provided by the cash value accumulations inside of permanent life insurance policies. These benefits include policy loans, using the policy for collateral on loans, retirement income, cash withdrawals and **accelerated death benefits.**

Life Insurance Advantages:

1. Life insurance provides a guarantee of large amounts of cash payable immediately at the death of the insured. The amount of the death benefit payable is usually significantly greater than the premiums paid for the policy.

2. **Life insurance proceeds are paid directly to the beneficiary without a delay caused by administration of the estate of the insured** (and without public record).

3. Life insurance cash values provide instant availability to cash through the policy loans.

4. **Cash values** build in a life policy federal income **tax deferred**. Interest earned on policy cash values is generally not taxable unless or until the policy is surrendered for cash.

5. The **death benefit proceeds from life insurance are not subject to federal income taxes**.

Basic Terms and Definitions

Accelerated Benefits – A rider attached to a life policy which allows the owner to take a percentage of the face value of the policy in advance of the insured's death. The money must be used for life altering circumstances, such as entering a nursing home or for the terminally ill.

Accumulation Period – The time before an annuitant's retirement during which the annuitant is making payments into their annuity. Sometimes referred to as a Deferred Annuity.

Adhesion – An insurance contract is a "take-it-or-leave-it" contract. The insurer makes up and forms the contract issued to an insured, and the insured must adhere to those terms. Any ambiguities in an insurance contract will be settled in favor of the insured. ***An insurance contract is a contract of adhesion.***

Adjustable Life Policy – A form of whole life insurance which allows changes on the policy face amount, the amount of premium, and the length of the premium payment period.

Adjustable Premium – A policy where the ***insurance company*** has the contractual right to increase or decrease premium payments.

Admitted Insurer – An insurance company authorized and licensed to transact business in a specified state.

Alien Insurer – An insurance company that is incorporated outside of the United States.

Adverse Selection – The tendency of less favorable insurance risks to seek or continue insurance to a greater extent than others who are preferred risks.

Annuitant – The person during whose life an annuity is payable. The owner or owners of the policy. There can be more than one annuitant for the same policy.

Annuity – A stipulated sum payable at certain regular intervals during the lifetime of one or more persons, or payable for a specified period only. A means of liquidating an estate or lump sum of money. These policies are primarily designed to pay benefits during the life of the insured rather than waiting for them to die.

Annuity Certain (a.k.a. **Period Certain Annuity**) – A contract that provides an income for a specified (certain) number of years, regardless of life or death, to either the living annuitant or to their beneficiary if deceased.

Applicant – The person who makes the application for insurance and who is proposed to be the policy owner. They must have insurable interest in the insured.

Application – A form supplied by the insurance company which is a formal request for insurance coverage. The insured, owner, and producer must sign the application, and it is part of the insurance policy (consideration).

Assignment – The signed legal transfer of interest, rights, or benefits of a policy from a policy owner to another party (the assignee). ***A living benefit right of the policy owner. Examples include: Collateral Assignment (used to guarantee a loan) and Absolute Assignment (used when gifting a policy to another).***

Attained Age – With reference to an insured, their attained age is their current age.

Authorized Insurer (a.k.a. **Admitted**) – An insurer licensed to transact insurance in a specific state.

Aviation Exclusion – It excludes coverage for death or disability due to aviation (*other than as a fare-paying passenger on a scheduled commercial airline*).

Beneficiary – A person to whom the proceeds of a life or accident policy are payable when the insured dies. If there is no beneficiary, the proceeds will go into the insured's estate.

Beneficiary, Primary – The person who is first in line to receive the proceeds of a life or accident policy when the insured dies.

Beneficiary, Contingent a.k.a. Successor beneficiary – A person to whom the proceeds of a life or accident policy are payable only when the ***primary beneficiary dies*** **before or at the same time** ***as the insured dies***.

Beneficiary, Irrevocable – A beneficiary whose interest cannot be revoked without their written consent, because the policy owner has made the beneficiary designation without retaining the right to revoke or change it. This is in contrast to a Revocable Beneficiary which can be changed at any time by the owner of the policy.

Buy-Sell Agreement – A legal contract that determines what will be done with a business in the event one of the owners dies or becomes disabled. One partner agrees to sell their share of the business if they die or becomes disabled, and the other partner agrees to buy a partner's share of the business if that partner dies or becomes disabled.

Buyer's Guide – A booklet that describes an insurance policies concepts and suggestions. It also provides general information to help a policy owner make an intelligent decision.

Cancellation – The termination of coverage in "advance" of the policy's renewal date.

Cash Value – The amount of equity or ownership of any cash accumulated in a life policy.

Certificate of Authority – A document issued by the Office of the Insurance Commissioner giving the authority to transact insurance business in a specified state. Once an insurer is "authorized" to do business in a state, they are referred to as "admitted" in that specific state.

Certificate of Insurance – A legal document that specifies that an insurance policy has been issued. Examples of a Certificate of Insurance include your auto insurance card or your group insurance card.

Common Disaster Provision (a.k.a. short-term survivorship clause) – This provision provides that the primary beneficiary must survive the insured by a stated number of days to receive the policy death benefits. If the primary beneficiary does not survive for the designated period, the death benefits will go to the contingent beneficiary.

Concealment – The withholding of a fact that would affect the validity of a policy of insurance. If the concealment is found to be "***material***" to the policy of insurance, it could cause the voiding or cancellation of the policy. (See "incontestability period")

Conditional Receipt – These are given by Life and Disability Producers to policy owners who provide premium at the time of application, conditional receipts are in effect until a policy issues. Coverage is conditionally issued, provided the insured meets all underwriting requirements.

Consideration – A contractual term that requires that something of value be exchanged for a contract to be legal. Premium from the insured and a promise to pay from the insurer is consideration.

Consideration Clause – The consideration or premium clause is that part of an insurance contract setting forth the amount of initial and renewal premiums and frequency of future payments. In contract terms it is the value given between parties for a contract to be legal.

Contract – An agreement between two or more parties which is enforceable by law.

Convertible (a.k.a. **Convertibility** feature) – A policy provision which allows a policy owner to change one contract for another without having to show evidence of insurability.
Convertible Term – A contract which may be converted to a permanent form of life insurance **without the insured having to show proof of insurability** (non-medical transactions).

Death Benefit (a.k.a. **Death Proceeds**) – The amount received by the beneficiary upon death of the insured. The death benefits are received by the beneficiary income tax free.

Defamation – An unfair business and trade practice in which one person or company makes false or inaccurate statements about another party with the intent of injuring the reputation of that party.

Deferred Annuity – An annuity providing for income payments to begin at some unspecified future date (usually retirement). It is equivalent to a tax-deferred savings account.

Dividend (a.k.a. Return of unused premiums) – A policy owner's share in the divisible surplus of a company issuing insurance on the ***participating*** plan. ***Insurance policy dividends are* NOT *taxable to the owner.*** Dividends are paid by **Participating life insurance companies**. Dividends may NOT be guaranteed to a policy owner.

Domestic Insurer – An insurance company that conducts business transactions in the state where they are incorporated. *Examples of Washington State's domestic companies include PEMCO and Safeco.*

Effective Date (a.k.a. **Inception Date**) – The date when an insurance policy's coverage begins.

Endorsement (a.k.a. **Riders**) – Endorsements or Riders are documents that broaden coverage, restrict coverage, or change the contract. An endorsement is not valid unless signed by an executive officer of the company and attached to and made part of the policy.

Equity Index Life (**EIL**) – These are variations of permanent life insurance plans which provide features giving a sense of stability through a ***guaranteed minimum interest rate,*** tax-deferred interest accumulation, and access to the cash value through withdrawal and loan provisions. In addition, the EIL products offer equity index-linked (stock market) returns with the potential to beat inflation and protection in the contract against downside market risk.

Exclusions – A policy provision which states the terms and conditions in which benefits will NOT be paid. Most life insurance policies list three exclusions: War, Aviation, and Hazardous Occupations and Hobbies.

Expiration – The date specified in the policy as the date that coverage ends or terminates.

Fair Credit Reporting Act – Federal laws requiring an individual to be informed if they are being investigated by an inspection company. The law requires that the consumer must be notified that a credit report will be sought and told how it will be used. The consumer must be told how to obtain a copy of the report.

- ✓ Information on the credit report can be disputed, and if **the reporting agency** cannot prove the disputed information is accurate, the information must be removed from the person's file **within 30 days**.

Fiduciary – A person who is held in a position of trust for another has fiduciary responsibility to that person. A producer has fiduciary responsibilities to any clients from whom they collect premiums.

Fixed Annuity – An annuity that offers fixed payments and guarantees a minimum rate of interest to be credited to the annuity funds.

Foreign Insurer – An insurance company doing business in a specific state, but is incorporated in another state.

Fraternal Benefit Society – A life or disability insurance company formed to provide insurance coverage for members of an affiliated lodge, religious organization, or fraternal organization with a representative form of government.

Fraud – Intentional misrepresentation or deceit with the intent to induce another to part with something of value. For example, filing a false claim. Generally, a lie on an application is considered a misrepresentation but NOT fraud.

Free Look – A provision whereby a policy owner has a ***minimum number of days*** to examine their new policy, from the date the policy is received, at no obligation. All premiums must be refunded within 30 days if the policy is rejected by the owner.

Grace Period – The period of time after the due date of a premium during which the policy remains in force without penalty. Life insurance contracts require a minimum grace period of 31 days. ***The insured is covered during the grace period, but the unpaid premium is deducted if death proceeds are paid.***

Guaranteed Renewable – An insurance contract that the insured has the right to continue in force by payment of premiums, and which the insurer has no right to make unilaterally any change in any provision, other than a change in premium rate for classes of insureds.

Hazard – Anything that increases the chance of a loss. Examples include smoking, being overweight, having a heart defect, or being in a high-risk profession such as a logger or racecar driver.

Incontestable Clause – States that after a policy has been in force for **two years**, the policy may not be canceled or a claim voided for any reason other than for fraud or non-payment of premium.

Insurable Interest – This exists when the death or disability of another warrants compensation. **The owner/applicant must have insurable interest in the insured.** Everyone has insurable interest in themselves. Other examples include: Business partners, spouses, or parents and children. **Insurable interest must exist at the time of the application.**

Insurability – The acceptance or qualifying of an application by the insurance company to issue a policy.

Insurance – A formal social device for transferring risk (specifically the financial impact of the loss) by spreading it among a sufficiently large number of similar exposures. Insurance is a contract whereby one undertakes to indemnify another or pay a specified amount upon determinable contingencies.

Insured – The individual covered by the insurance.

Insurer (a.k.a. **Insurance Company**, **Carrier**, **Issuer**, or **Principal**) – An entity that transfers risks from the insureds to themselves and pays for the financial impact of the loss of any insured.

Insuring Clause (a.k.a. **Insuring Agreement**) – **The insurance company's promise to pay**. It defines and describes the scope of the coverage provided and limits of indemnification. The insuring clause is ***found on the first page of the life insurance contract.*** It is sometimes called "the heart of the contract."

Joint with Survivorship Annuity – An annuity issued on two lives under which payments continue in whole or in part until the death of both annuitants.

Joint Life Policy (a.k.a. **First to Die**) – An insurance contract written on two or more lives, with the insurance payable at the death of the first insured. **A joint policy averages the risk factors (i.e., age and sex) to establish the premiums. This is one reason a joint policy is less expensive for covering two individuals than purchasing two separate policies.**

Joint Life Policy (a.k.a. **Last Survivor, Second to Die**, or **Survivorship Life**) – A **joint** policy that covers two insureds and pays the proceeds after the second insured dies. This is a type of ***joint whole life policy and*** usually is used for **estate planning**. ***A joint policy averages the risk factors (i.e., age and sex) to establish the premiums. That is why a joint policy is less expensive for covering two individuals than purchasing two separate policies.***

Joint Life Annuity – An annuity issued on two lives under which payments cease at the death of either of the two annuitants. **Very risky for the annuitant.**

Law of Large Numbers – A principle that states that the larger the number of similar exposures considered, the more likely or closely the actual losses reported will equal the expected losses. Accuracy and credibility increase with more considered results.

Level Premiums – A policy premium that remains the same over the period of time premiums are due.

Life Annuity (a.k.a. Pure, Straight, or Life with no refund Annuity) – A contract that provides an income for the life of the annuitant (payments stop at death). **Very risky for the annuitant.**

Life Insurance – A **legal contract**, governed principally by state law, which promises to pay a specified amount of money to a beneficiary when the insured person dies. ***The contract is between the insurance company and the policy owner***, who pays premiums in exchange for the promised death benefits. Frequently the policy owner is the person insured, but the policy can be owned by someone other than the insured. See third party owner.

Limited Pay Life Insurance – A form of whole life insurance characterized by premium payments only being made for a limited number of years.

Material Fact – Information about the insured that if known would change the underwriting basis of the insurance, and that would cause the insurer to refuse the application. A material fact could cause the policy to have been issued on "substantially different terms" such as charging a higher premium (i.e., surcharge or rate-up) or issuing the policy with an exclusion rider (i.e., aviation, hobby, or occupation).

Medical Information Bureau (**MIB**) – An **insurance industry bureau** to which life and health insurers report applications and other reports about applicants. The information is then available to other member companies for underwriting purposes. **The main purpose is to detect application fraud. The applicant has the same rights as those available under the Fair Credit Reporting Act**.

Misrepresentation – On the part of an insurer or its producer, falsely representing the terms, benefits, or privileges of a policy to an insured or prospective insured. On the part of an applicant, falsely representing the health or other conditions of the proposed insured on the application. **A misrepresentation is a lie.**

Mode of Premium Payment – The method of paying policy premiums. They include annual, semi-annual, quarterly, or monthly.

Mortality Table – This lists the mortality experience of individuals by age; it permits an actuary to calculate, on average, how long a male or female of a given age may be expected to live. *Mortality tables end at age 100.*

Mutual Insurer – An insurance company that has no capital stock and is owned by the policy owners. Mutual companies sell participating policies because they share in the profits with the policy owners by paying dividends. "Participating" Whole Life policies pay dividends.

Nonadmitted Insurer – An insurance company that does not have a certificate of authority to transact insurance business in a specific state. Often referred to as an "Unauthorized" company.

Non-Forfeiture Options (a.k.a. **Standard Nonforfeiture Law**) (**NFOs**) – These privileges are required under the terms of a whole life insurance contract after cash values have been created. To summarize, the carrier cannot keep your money should a person stop paying and the contract cancels due to non-payment.

Non-Forfeiture Options in annuities: the carrier cannot keep your money should a person stop paying during the accumulation period.

Nonmedical – A life or health insurance policy that is underwritten based on the insured's statement of health rather than a medical examination.

Old Age, Survivors, Disability, and Health Insurance Benefits (**OASDHI**) – The true name for Social Security.

Paid-Up Insurance – Insurance on which all required premiums have been paid. The term is frequently used to mean the reduced paid-up insurance available as one of the non-forfeiture options.

Participating "Par" Policies – Mutual and Fraternal Insurance Companies issue participating policies, which in turn pay dividends (profits) to the policy owners.

Payor – The person or entity who pays the premium.

Payor Waiver Benefit – ***Available under juvenile life insurance policies.*** A provision can be made in all forms of juvenile insurance for the waiver of premium payments in the event of the death or total disability of the person responsible for the payment of premiums.

Peril – The cause of a loss. Various examples of perils include an accident or sickness which causes death or a fire that damages a house.

Permanent Life Insurance – A general term used to refer to various types of whole life policies that remain in effect to age 100 so long as the premium is paid.

Policy Owner (a.k.a. **Policyholder** and is usually the applicant) – The party who has the right to exercise the rights in the contract. The owner may be a different party than the insured, who then would be known as a third-party owner.

Premium – The payment or consideration that the insured makes to the insurance company for insurance coverage.

Premium (the insured's ***consideration*** to the insurer):

1. **Fixed** (a.k.a. **level**) premium refers to the premium paid which remains the same throughout the life of the contract. It is a method of leveling off the cost of insurance so as not to have it increase each year until it might become unaffordable.
2. **Flexible** premium means the policy owner is permitted to increase or decrease their premium.
3. **Adjustable** premium means the premium may be increased or decreased by the **insurance company** to reflect the insurance company's loss or profit experience.
4. **Gross Premium** = Mortality (charge), Interest (credit) and Expenses (a.k.a. load charges). Producers sell gross premium policies and aren't even aware of the net.
5. **Net Premium** = premium ***without*** the expenses added in.

Principal Amount – This amount usually refers to the face amount or value of a policy.

Producer – A person licensed to transact insurance business.

Proceeds (a.k.a. **Death Benefit**) – The amount of money payable by the insurance company at the insured's death or at the policy maturity. This may be lower than the initial Face Value if some of the cash value has been removed, such as by a loan.

Pure Protection – This refers to ***term life insurance protection***, which pays a death benefit but builds no equity or cash value in the contract.

Qualified Plan – A retirement plan governed by the Federal Government. Usually allows tax deductions for any contributions and tax-deferred growth on those contributions. Full taxes will be due when withdrawn. Has early and late withdrawal penalties.

Rebating – Any giving money back to a person or a guaranty to give money back to a person as an inducement for that person to purchase insurance. Illegal in the State of Washington.

Refund Life Annuity (a.k.a. **Life with Refund**, **Cash Refund**, or **Installment Refund Annuity**) – An annuity providing that if the annuitant does not receive the full amount of the annuity value during their life, any remaining value may continue to a beneficiary.

Reinstatement – Allows putting a lapsed policy back in force by producing satisfactory evidence of insurability and paying the required premiums. In life insurance, the insured has three years to reinstate.

Renewal Term – Allows the policy owner to renew an insurance policy by just paying the required premium, but will NOT require any evidence of insurability by the insured.

Representation – Any statements made by an applicant in the application believed to be true to the best of the applicant's knowledge. These are not guarantees, but statements considered to be substantially true to the applicant at the time of the application. Representations are about past and present information.

Return of Premium *Policy* (ROP) – A **newly introduced term life insurance** policy providing death benefit ***protection if the insured dies*** and a ***return of premium feature if the insured lives.***

Return of Premium *Rider* – A type of *rider* that will pay an amount equal to the sum of all premiums paid to date ***if the lives to a specified term***, such as 10, 15, or 20 years after the policy is issued. Works the same as the ROP.

Revocable Beneficiary – A beneficiary whose rights in a policy are subject to the policy owner's reserved right to revoke or change.

Rider – The term is used loosely to refer to any supplemental agreement attached to and made a part of the policy, whether the policy's conditions are expanded and additional coverage added, or when some coverage or condition is waived.

Risk – **The probability or chance of a loss**. A *Speculative Risk* involves the chance of both loss or gain, such as investing in the stock market, and is not insurable. Pure Risk is only the chance of a loss and no gain. ***Only pure risk is insurable***, **not** speculative risk.

Settlement Options – Optional modes of settlement provided by life insurance policies in lieu of lump-sum payments. ***Identical to the annuity payout options***.

Seven-Pay Test – A test applied to life insurance contracts under the Internal Revenue Code that is designed to determine if the contract is primarily an investment rather than a life insurance contract. **Premiums during the *first seven years* of the contract may not exceed seven annual net level premiums**. ***A life policy that violates the seven pay test is considered to be over-funded.***

Single Premium Whole Life – A life insurance policy that provides a guaranteed death and endowment benefit for one single lump-sum premium payment. Has ***immediate cash value*** that will build and equal the face amount of the policy when the insured reaches age 100 and endows.

Speculative Risk – The chance of either gain or a loss. The value of a home or stock going up or down in value is a speculative risk. This type of risk is NOT insurable. Only pure risk is insurable.

Standard Provisions – These are usually approved and required by individual states and must be included in an insurance contract.

Stock Company – A company owned by stockholders. Profits or dividends are paid to the stockholders (NOT the policy owners).

Straight Life – A basic life insurance policy that charges a fixed premium for the lifetime of the insured. May also be called a Continuous Premium Whole Life.

Substandard Risk – A person who is not as healthy as a standard risk but is still insurable. Often requires a high premium to be paid.

Suicide Provision – Life insurance policies provide that if the insured commits suicide within **two years** of the effective date or issue date of the policy, **the company's liability will be limited to a return of all of the premiums paid (no interest), but not pay any death benefit. Meaning, death due to suicide is excluded from coverage for a maximum of two years.**

Surrender – The policy owner returns the policy to the insurance company in exchange for the policy's cash surrender value or other equivalent non-forfeiture values.

Temporary Agent – A person who is licensed to act as an agent for a brief period of time (no more than 180 days in Washington) without taking a written examination. Temporary licenses are commonly granted to allow someone to continue the business of an agent (to legally represent that agent) who has died or becomes disabled.

Term Insurance (a.k.a. **Pure Protection**) – The least expensive of all types of life insurance protection; pays only upon death; builds no cash value. Types include Level, Decreasing, and Increasing, which refer to their face value. They may sometimes be Return of Premium policies, which return the premium should the insured live beyond the policy term. This pure protection life insurance coverage which is in effect for a period of time or a term, including lengths such as 1, 10, or 20 years. After the stated term of the policy the policy ends, unless renewed by the owner.

Tertiary Beneficiary – The third person in line to receive the death proceeds of a life insurance policy. Will receive the death proceeds only if the primary and contingent beneficiaries die before the insured dies.

Third-Party Ownership – A person other than the insured, who has ***insurable interest***, who may apply for and own a policy covering the insured, and is entitled to the benefits and other rights provided. The **first party** is the insured; the **second party** is the insurance company; and the **third party** is the owner of the contract, if other than the insured. For example, to prevent the financial impact of death, parents will purchase and own policies on their children, or business partners will insure one another.

Twisting – The ***illegal practice*** of inducing a policy owner in one company to let lapse, terminate, forfeit, surrender, retain, or convert *(i.e., give up or keep)* any insurance policy by using unfair advertising practices or by misrepresentation. **Failing to fill out a replacement form when replacing an in-force policy is also considered twisting.**

Underwriting – The process of selection, classification, and rating of risks. Simply put, underwriting is a ***risk management selection process***. The selection process consists of evaluating information and resources to determine how an individual will be classified. For example, preferred, standard, or sub-standard.

Unilateral Contract – A contract characteristic that obligates only one party to a contract. The policy owner is not required to pay premiums and can cancel the policy whenever they want to. However, if the premium is paid, the insurer is required to pay death proceeds should the insured die.

Universal Life Insurance – These are *flexible premium, current assumption growth, and adjustable death benefit forms of permanent life contract* containing ***renewable term insurance*** and a cash value account that generally earns interest at a higher rate than a traditional policy. There is a minimum guaranteed return and potential market upsides. Premiums are deposited in the cash value account after deductions for expenses and the cost for the term coverage.

Valued Contract – A contract that pays a stated amount in the event of a claim or loss.

Variable Annuity – An annuity under which the amount of each periodic payment fluctuates according to the investment (stock market) performance of the ***separate account.***

Variable Life Insurance – Life insurance under which the benefits are not fixed but relate to the value of assets behind the contract at the time the benefit is paid. Variable life insurance has an investment feature that allows cash value (known as accumulation units) to be invested in the stock market.

Waiting Period – The time period between when a loss occurs and a benefit is paid by the insurer.

Waiver of Premium – This provision or rider exempts the insured from paying premiums after they have been disabled for a specified period of time (known as a waiting period).

Waiver of Premiums with a Disability Income Rider – Works the same way the waiver of premium works but also ***pays a regular monthly income to the insured who becomes totally disabled***.

Warranty – A ***written (expressed) guarantee*** in the contract (***policy***) that something ***is true in every respect, and will remain true throughout the contract term.*** For example, a hotel will ***warrant*** to the insurance company that its sprinkler system will be in operation 24 hours a day to help prevent and limit the damage caused by fire.

- In any insurance contract or policy, the warranty given by the *insurance company* is *their promise to pay*. This is found in the ***insuring agreement*** ***(clause)***.