Contents

1. Beneficiary Designations

The insurance contract is one made for the benefit of a beneficiary and since they can sue the insurer to collect the policy proceeds after the death of the insured, they may be considered a party to the contract.

Individuals or N**amed Party** specifies a person by name to receive the death proceeds when the insured dies—for example, Jane Doe, the spouse.

Class designates a group rather than an individual name. This saves having to change beneficiary designations if someone in the group dies or because of additions due to birth. For example, all my children or all my grandchildren.

a) Primary and Contingent

- The ***primary beneficiary*** is the person designated to receive the death proceeds when the insured dies.
- The ***contingent beneficiary*** only gets the death benefit if the primary beneficiary dies ***before the insured or at the same time*** as the insured dies.
- If the insured and primary beneficiary die in the same accident and there is **no evidence** that the primary beneficiary outlived the insured, the proceeds will go to the **contingent beneficiary**.
- Tertiary is the third in line and only receives the proceeds if both the primary and the contingent predecease the insured.

b) Revocable and Irrevocable

A Revocable beneficiary may be changed at any time by the policy owner, in writing, to the insurance company. The insurance company then issues an endorsement which in effect changes the insurance policy (contract).

An Irrevocable beneficiary may only be changed with written consent from the irrevocable beneficiary **and** the policy owner.

- **No assignment, loans, or withdrawals are allowed** without the written consent of the irrevocable beneficiary.
- The owner may still choose dividend options, including the cash option, and may still change his premium payment mode.

- The irrevocable beneficiary has a vested right in the Face Value only and may ***continue to make the premium payments to keep the policy in force if it lapses, and is entitled to a copy of the policy***. However, the irrevocable beneficiary has no ownership rights in the contract.

E.g., Ms. M buys a small business, and it is financed by the former owner, Mr. W. The former owner needs to protect himself against the possibility of Ms. M dying before the note is paid. A life policy with Mr. W. as the irrevocable beneficiary can be taken out and when the business is paid for he can sign off as the irrevocable beneficiary.

c) Common Disaster Provision (not a law but a provision in a policy) states that as long as the beneficiary dies within a certain period of time following the death of the insured, it will still be treated as if the beneficiary dies first. The provision contains a ***short-term survivorship*** clause which states that if the insured and primary beneficiary die due to the same accident but the primary beneficiary dies within a certain number of days after the insured (10, 20 or 30 days and is stated in the life insurance policy), then the contingent beneficiary will receive the proceeds just as if the **primary beneficiary had died first.**

d) Spendthrift Clause : A spendthrift is a person who spends money extravagantly. This clause may be included as a rider, and it exempts the beneficiaries and creditors from receiving the policy proceeds other than how it was intended by the owner of the policy (i.e. a settlement option other than cash). It can also prevent payment to a creditor from the trust if the credit was extended based on future distributions.

e) Listing a beneficiary is NOT required. Since a beneficiary has no ownership rights in the life insurance contract, a beneficiary's signature **IS NOT** needed on the application for insurance. A life insurance contract does **NOT** require a beneficiary on the application.

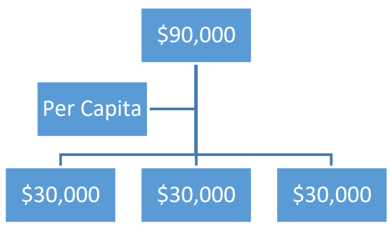
- ✓ ***With no beneficiary, any death proceeds paid would go to the insured's estate.***
- ✓ ***This will increase the value of the estate and may result in estate taxes.***
- ✓ ***This will allow creditors to claim funds owed them from the estate.***

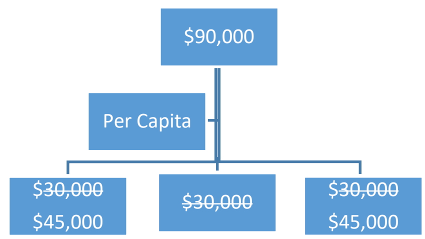
f) Minors as a beneficiary is not wise because minors are not legally competent to receive policy proceeds. Proceeds can be paid to a properly appointed guardian or trustee for the minor. If the insurance company holds the proceeds, it must pay interest on the proceeds.

g) Designation by Class designates a group rather than an individual name. This saves having to change beneficiary designations if someone in the group dies or because of additions due to birth. For example, all my children both natural and adopted, or all my grandchildren.

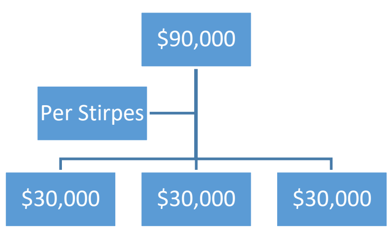
Classes of persons may be listed as 'per capita' or 'per stirpes'. Per Capita is per head or per person, per stirpes is Latin for the root. Each one will have its own uses. How do they work though?

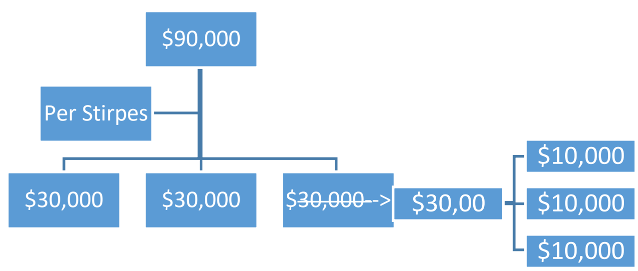
Joan has 3 children and names them in a class as the beneficiaries, ***per capita*. If one of her children predeceases Joan, the share that would have gone to that child is split between the others. This is fine if the deceased person has no children to be named as heirs. If they do have children though, those children would receive nothing.





Jane has 3 children and names them in a class as her beneficiaries, ***per stirpes*. If one of the children (Ryan) predeceases Jane, and Ryan has children, when Jane dies the death benefit will be split 3 ways with Ryan's share divided among his 3 children.





h) An Estate, Trust, or Company may be named as a beneficiary to receive the policy proceeds. There are drawbacks as well as advantages to these designations. ***If the money is left to an estate or a trust, any creditors will have access to the death benefit.*** If the money is left to an estate, it may tip the value of the estate up to where they owe estate taxes.

2. Settlement Options… This **policy provision** explains how the death benefit is paid should the insured die while the policy is in force. It can also be used to disburse funds to an insured who elects to surrender the policy for its cash value. These options work the same as the annuity payout options. While about 98% of death benefits are made in a lump sum, a portion of death proceeds are disbursed in other ways. These optional disbursements are known as settlement options.

The Right to Elect or Change Options rests with the policy owner. The policy owner may choose any option under which the proceeds will be distributed to the beneficiary, regardless of the beneficiary's wishes. If the owner does not choose an option, the beneficiary has the right to decide how to receive the proceeds.

In addition to using settlement options for death proceeds, policy owners also may elect to use settlement options for the proceeds they receive when a policy endows or is surrendered for its cash value. An Endowment policy is a cash value policy that endows on a date chosen by the insured. It is not on the exam nor covered in the text.

(*remember CLIFF: Cash Life Interest Fixed Fixed)

a) **Cash**, a lump sum is paid to a beneficiary.

b) **Life Income** Options are the same as the Life Annuity Options: the person being paid is paid for the remainder of their life, regardless of how long that is or the balance of funds in the account.

i) Straight or Pure Life w/ No Refund – the beneficiary/annuitant is paid an income for the rest of their life.

ii) Life w/ Refund –

- the beneficiary/ annuitant is paid an income for the rest of their life but if they die before the balance has been paid out, the remainder of the funds are refunded to that person's beneficiary.

iii) Life w/ Period Certain –

- the beneficiary/ annuitant is paid an income for the rest of their life and if they die before the chosen period has passed (e.g. 10 years), the same payment is made to that person's beneficiary until the end of that period.

iv) Joint Life Annuity pays an income to two annuitants (with one check) and terminates when the first annuitant dies. **There is no beneficiary.** This is a **very risky** option if this is to be the only income. It has the higher payout amount of the two joint options.

v) Joint Life w/ Survivorship pays an income to two annuitants (with one check) but will continue to pay the second annuitant when the first annuitant dies. The annuitant chooses the amount of the continued payout, such as 1/2, 2/3, etc., of the original payout, at the time the annuity contract is purchased. However, **when the survivor (annuitant) dies, all payouts stop.** The survivor is not a beneficiary, they are an annuitant.

The difference is the 100% with full survivorship will be a lower amount than 100% with partial survivorship for the same investment. Less later = More now.

Payout amounts are determined by the average age.

c) **Interest Only** Option - The insurance company holds the proceeds and pays the interest earned to the beneficiary. **The interest is taxable**.

d) **Fixed Period** Option is the same as the installment annuity option. The beneficiary receives equal payments of both principal and interest over a designated period.

e) **Fixed Amount** Option is the same as the installment amount annuity. The beneficiary receives payment of a predetermined amount consisting of both principal and interest.

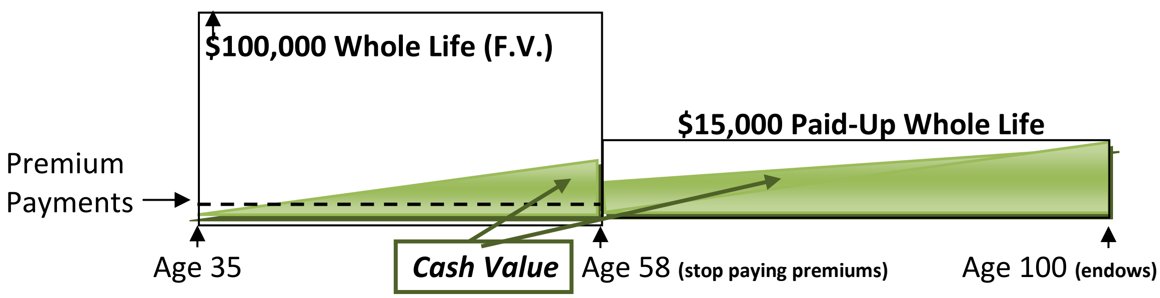
3. Nonforfeiture Provisions, **a.k.a. Nonforfeiture Options (NFO),** must be included in the policy under the ***Standard Nonforfeiture Law*** which prescribes that a policy's cash values must be made available to a policy owner should he stop paying the premiums on his policies.

A permanent policy must have cash value by the end of its third year. As the cash value builds each year so do the values associated with the nonforfeiture options. The common options in cash value policies include: **Reduced Paid-Up Insurance, Extended Term Insurance or Cash Surrender. (REC)**

a) **Reduced Paid-Up Insurance**

- The Cash Value is used as a single (NET) premium to buy paid-up coverage on a non-medical basis.
- ***The policy owner will receive a policy that is paid in full for life.***
- Premium is based on the insured's attained age.

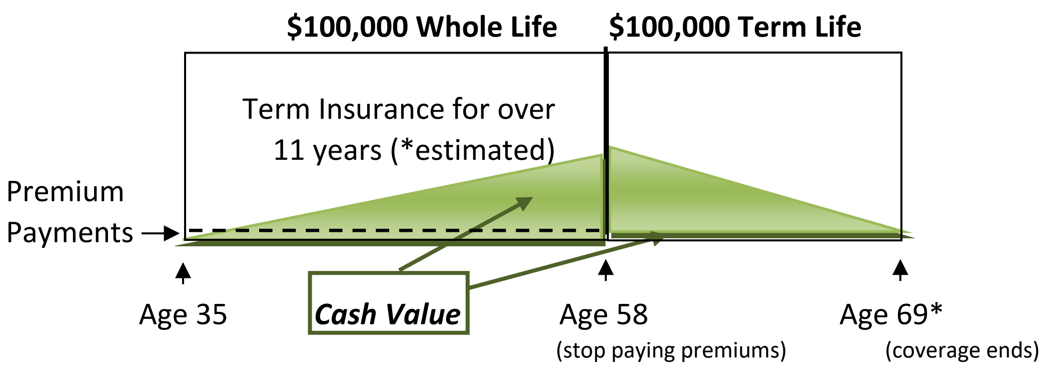
(The face value is reduced, the policy is paid up)



b) Extended Term Insurance, a.k.a., **Automatic Option:** The policy owner uses cash value (minus any loan amounts) as premium to purchase **term insurance** in the original face amount for as long as the cash value lasts.

- The insured's attained age is used to calculate the premium each year.
- Net premium is used to purchase term coverage on a non-medical basis.
- ***This option goes into effect automatically if no other option is chosen by the policy owner.***

(The same amount of coverage is extended in the form of a term policy)



c) Cash Surrender allows the owner the option to surrender the policy (send it back to the company) at any time in return for its cash value. This in effect terminates the policy and ends the promise to pay a death benefit. The insurance company does have up to six (6) months to pay the cash to the owner. This is known as the Delay Clause.

- A policy surrendered for its cash value <u>cannot</u> be reinstated.

4. Dividend Options…(OCRAP)

When a policy participates in the favorable investment, mortality, and expense experience of the insurer, the policy owner receives *dividends* as a refund of an *overcharge* in premiums. Dividends are **not** taxable since they are a return of after-taxed dollars.

Dividends ***cannot be guaranteed*** (constitutes **illegal rebating**) because a company's profit is not guaranteed. Companies that pay dividends are also called **<u>participating companies</u>** and issue 'par' or participating policies.

The Right to Elect or Change Dividend Options rests with the ***policy owner***. The options include **Four Basic Options + the Fifth Option.**

The 4 basic options are required by law, the 5th option – one year option - is offered by companies as an alternative for the consumer.

a) One-Year Option (a.k.a. Fifth Option) is used to buy one (1) year term insurance coverage. Usually the amount of the term coverage is limited to the cash value in the policy. The option uses attained age and net premiums.

- ***No evidence of insurability is required.***
- ***This term coverage is <u>not</u> renewable or convertible***.

b) Cash is paid annually on the anniversary date.

c) Reduced Premium Option The amount of the dividend is applied to the next premium.

d) Accumulation of Interest means the dividend stays with the insurance company in a separate savings account for the insured and earns a competitive interest rate. The money is not put into the cash value account so it can be withdrawn without affecting the cash value. <u>The interest earned on the dividend is taxable, the dividend is not.</u>

e) Paid-Up Additions (no evidence of insurability is needed):

- Dividends are used as a single (NET) premium to purchase additional coverage that is fully paid for. The coverage is the same as the original policy. The option uses attained age for premium calculation.
- This is treated as the automatic option if no other one is chosen. If reduced premium is chosen and there is still money left over after the premium has been fully paid, paid-up additions will be used for the balance.
- Can only use current or future dividends to purchase paid-up additions. Previously paid options cannot be changed.

*The Dividend options, Non-forfeiture options and the Settlement options can be remembered by their acronyms, **OCRAP**, I ran into a **CLIFF** and **REC**ed my car!*