Table of Contents

I. Life Insurance Policy Provisions and Options 1

A. Common (Standard) Provisions....1

1. Entire Contract....1
2. Insuring Agreement....1
3. Right to Examine....2
4. Consideration....2
5. The Owner....2
6. Premium Payment.....2
   a) Modes....2
   b) Level or flexible....3
7. Grace Period....3
8. Reinstatement....3
9. Loan Provisions.......3
10. Withdrawals/ Partial Surrenders....4
11. Incontestability Clause....4
12. Assignment....5
13. The Suicide Clause....6
14. Misstatement of Age or Gender (Sex)....6
15. Conformity with State Statutes....6

B. Policy Exclusions.......7

I. Life Insurance Policy Provisions and Options

A. Common (Standard) Provisions

Some provisions are found in almost all life insurance policies, sometimes called common policy provisions. Policy provisions state the rights and obligations of both the policy owner and the insurance company under the insurance contract. The exact wording may differ from company to company, but the content and effect of the common provisions are constant in the industry and some are actual state laws.

1. Entire Contract provision states that the contract is made up of ***the policy itself, the attached application, and any riders or endorsements.***

- The contract cannot be changed *arbitrarily or unilaterally* by either party after the contract has been issued.
- No changes are valid unless approved and endorsed by an executive officer of the insurance company. Producers *do not have the authority to change the policy or waive policy provisions*.
- All statements made by the applicant on the application are deemed to be ***representations*** (statements believed to be true) and ***not warranties*** (statements guaranteed to be true).
- A "last will and testament" ***does not*** supersede an insurance contract. The insurer is bound by the terms of the contract just as the insured is.
- **The basic purpose of the provision is to provide assurance to the policy owner that he has all necessary documents with regard to his insurance coverage.**

2. Insuring Agreement (a.k.a. Heart of the Contract) tells the policy owner that the insurer agrees to pay the death benefit to the beneficiary upon the due proof of death of the insured. The insuring agreement (clause) is on the ***face or front page*** of the life policy.

- The face or front page of an insurance contract expresses the promise of the insurer and lists the name of the company, insured, amount of insurance carried, and mode and amount of premium, and the effective date of coverage.
- This provision represents the ***insurance company's promise to pay.***

3. Right to Examine (a.k.a. Evaluation Period a.k.a. **Free Look**) regulation gives the policy owner a ***minimum*** of 10 days to examine the policy from the date it is ***received by the policy owner***. **All premiums** must be refunded within 30 days or the insurance company must pay an additional 10% penalty to the owner should the policy be returned. *Note: WA Law states that Life insurance replacement policies have a 20-day Free Look period.*

4. Consideration … identifies the fact that the agreement (or offer and acceptance) consists of the application and premium from the consumer in exchange for a policy from the insurer. In addition the policy owner must pay premiums as value to the insurance company for the insurer's promise to pay.

It also states the mode and amount of the premium payment.

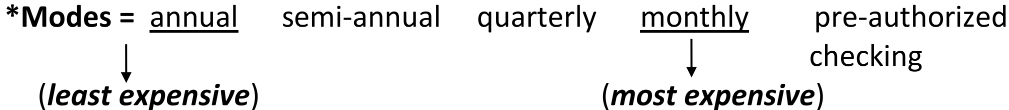
5. The Owner (a.k.a. **owner/applicant**) of the insurance contract is usually the insured. An exception is a ***third-party*** owner such as Business Insurance (a company would own the policy on their key employees) or a Juvenile Policy (a parent would own the policy on their children).

The owner's rights in a policy are found in the **Ownership Clause** and include:

- determining the disposition of proceeds (settlement options)
- assignment of the policy and benefits
- rights to the policy's cash value
- choosing the premium payment mode
- choosing or changing the beneficiary
- canceling and renewing the policy
- deciding how dividends will be used.

6. Premium Payment.

a) Modes Of premium are simply how often premium is paid. Other than a single premium policy there must be continued payment in exchange for the promise of coverage a.k.a. the policy.



The more often premium payments are made (12 monthly installments will cost more than just one annual payment), the higher the cost to the insured. When the company designs its policies, it expects the annual premium up-front.

b) Level or flexible refers to the premium payment plan.

- ✓ A term policy has a fixed or level premium for the length of the term.
- ✓ A Whole Life policy has a fixed or level premium for the length of the premium payment period. Remember limited pay? A person could pay off the policy in 10 or 20 years, that will be done with a level premium.
- ✓ Universal policies have a flexible premium. This means the consumer can choose how much to pay, increase it, decrease it, skip a payment, toss in a bonus, etc. There is a recommended minimum payment to keep coverage in force.

7. Grace Period is the period of time that there is still coverage even if premiums have not been paid. Consideration being an exchange of values between 2 parties, the consideration from the client is both the application and the premium. The premium must be paid in order to have the consideration from the company, i.e. the promise to pay or the death benefit. If the insured pays late, they are still covered. If they do not pay the policy lapses.

The grace period states if the insured dies during the grace period (**usually 31 days from the premium due date**), death proceeds are paid to the beneficiary, minus the past due premium. Insurers do have the option to charge interest on the past due premium when paid, however, most do not.

8. Reinstatement allows a canceled policy to be put back in force.

- The owner must pay **all back premiums plus interest** and the insured must ***show proof of insurability***.
- **If the policy is reinstated**, *it is usually reinstated back to the age of the insured when the policy was issued.*
- No more than ***three years*** may have passed from the lapsed date.
- Reinstatement starts new incontestability and suicide clauses.
- Reinstatement is **not** available if the policy has been surrendered for its cash value.

9. Loan Provisions… The owners of policies that build cash value may make use of the ***equity*** in their policies without cashing them in; they may do so through a policy loan.

- **Loan Interest…**The Company assumes that funds will earn a certain rate of return when it designs its policies. If money is withdrawn from the company in the form of a loan, it is no longer available for investment. Therefore, the company must charge interest on the funds it loans in order to meet its obligations. This interest is added annually to the balance of the loan and becomes principal.

- The maximum amount which can be borrowed from a permanent life policy is the ***amount of the cash value***.
- Should the loan plus interest meet or exceed the cash value, the policy will terminate following a grace period.
- Since this is a loan, there are no taxes on the money.
- **Nonpayment of Policy Loans** results in the insurance company either deducting the loan plus interest from cash value upon surrender or if the insured dies, the loan plus interest will be subtracted from the proceeds paid to the beneficiary.
- **Automatic Premium Loan** (APL)is used on a Whole Life Policy at no additional charge and authorizes the insurer to borrow policy cash value to pay premium to keep the policy in-force. This added APL provision prevents the unintentional lapse of a policy due to nonpayment of premium. It is a LOAN. The loan plus interest must be paid back.
    - With the APL, the policy will avoid going into the Nonforfeiture Automatic option (extended term option) if the insured does not pay the premiums of the policy.

10. Withdrawals/ Partial Surrenders are allowed on a limited number of policy types. Where generally withdrawing funds will lower the death benefit, there are times that taking the excess out of the cash value will eliminate the need for the policy to become a MEC. The money in the account grows tax free until it is taken out. Withdrawals of money come from the premium first and the growth second, so there may be no taxes on the funds.

Withdrawing funds from a plan that has been growing tax-deferred may trigger a taxable event. Generally the money comes out of the premium when withdrawing. Since the premium was paid with after tax dollars the money coming out is not taxed. If any of the money being withdrawn is considered growth, that portion is subject to income tax.

For example, Miss Mary has paid $10,000 in to her UL and it has a current cash value of $25,000. If she were to withdraw $8000 there will be no taxes. If she were to withdraw $18,000 the first $10,000 will come out tax free (remember she already paid taxes on the premium funds) and the remaining $8000 will be taxed as ordinary income.

Note: when a policy achieves MEC status it is still a life insurance policy and will still pay a death benefit, but, when funds are withdrawn they come out of the growth first and are taxed.

11. Incontestability Clause (consumer protection) states that after a policy has been in force for ***over two years***, the insurance company cannot contest or void the policy **except for fraud committed by the insured or nonpayment of premium**. The first 2 years of the contract are contestable.

If there is a ***misrepresentation*** (a lie) or a ***concealment*** (withholding of facts) discovered in the first two years, it must be ***material*** for the insurer to deny coverage or to cancel the policy.

- **Material** means that it is a fact that is important enough that had the insurance company known it, it could have changed either the decision to issue the insurance policy or to issue the policy on ***substantially different terms***. The misstated information is said to be ***material*** only if the truth would have resulted in the insurer making a different underwriting decision (i.e., a rate–up or surcharge of premium or an exclusion rider would have been attached to the issued policy).

- The insurance company must ***return all of the premiums*** (**no interest**) paid if a claim is denied or a policy is canceled during the first two years of the contract.

- Lying about using tobacco products, age, or gender is ***NOT*** considered material. The coverage will be adjusted if the lie is about age or gender, and the non-tobacco use discount will be removed if the lie is about using tobacco.

- This provision protects the insurer against adverse selection.

- This provision protects the consumer; first by limiting the discovery period to 2 years and second by refunding the premium if someone misrepresented a material fact and there was a claim within the first 2 years.

There are a few reasons the insurer may void the policy after the 2-year period has passed, they all are types of fraud. When the insured fills out the application and has another do the medical exam in their name in order to qualify, that is fraudulent impersonation. If there is no insurable interest *at the time of application* and the policy is taken out for profit only if an insured dies. This does not mean a person cannot sell the policy to another at a later time for cash up front now, this is known as a viatical settlement. Finally, a contract purchased with intent to murder.

12. Assignment… the policy owner transfers the rights in a policy to another. Because life insurance is treated as personal property, the owner can – after notifying the insurer- sign their name and give up some or all of their rights in a policy to another.

- ***A Collateral*** assignment transfers **part** of the rights to supply security (collateral) for a loan. This is a ***temporary and partial*** assignment; only ***some of the "incidents of ownership"*** are transferred. The right to the cash value or the death benefit if the loan is in default but only up to the limit of the debt owed. The remainder belongs to the insured or the beneficiaries. Additionally, the right to exercise the non-forfeiture options if the premiums are not paid and even dividends on par policies are given to the lender. After the debt is satisfied, the rights are returned to the policy owner upon transferring back to the owner by the lender notifying the insurer. Since this alters the death benefit to the beneficiaries, it may require replacement paperwork.

- ***An <u>Absolute</u> assignment*** transfers **all** of the rights to another. This may be used for giving life insurance as a gift so that a tax deduction, in the amount of the cash value, may be taken by the owner. A third-party owner may assign ownership of the policy to the insured, a key person retires, a child has a job and can pay their own premium, etc.
    - This is a ***<u>permanent and complete</u>*** assignment and ***all "incidents of ownership"*** are transferred.

13. The Suicide Clause

The Suicide Clause excludes death due to suicide for a maximum of **two years** from the ***effective date of the coverage***. All premiums paid (***no interest***) must be refunded to the beneficiary if the insured commits suicide within the first two years of the contract. After 2 years the death benefit is paid in full regardless of the cause.

- The suicide clause is intended to prevent adverse selection. That is, the two-year limit lets the company protect itself financially against situations where life insurance would be purchased in direct contemplation of suicide.

14. Misstatement of Age or Gender (Sex)

Misstatement of Age or Gender (Sex) provision states that if the age or sex of the insured is found to have been misstated, ***the amount of insurance will be adjusted*** to the amount which would have been purchased by the premium had the correct age or sex been known.

- This clause ***does not*** have the two-year contestability limit for discovery.
- A misstatement of age or sex is *not material* and **will not cause the voiding** of a claim or cancellation of a policy and will always cause an adjustment in the benefits.
- For example, John purchased a life policy for $50,000 issued at age 35 at an annual premium of $900. When John dies, the true age of John when he purchased the policy is discovered to have been 38, not 35. The $50,000 death benefit will be lowered to that which would have been purchased by the $900 in premium had the correct age been known.

15. Conformity with State Statutes…

"This policy is subject to the laws of the state where the insured resides. If any part of the policy does not comply with the law, it will be treated by us as if it did."

B. Policy Exclusions…The *exclusion* section spells out circumstances under which the policy proceeds would not be paid. Not all policies have all the following exclusions, some policies may have no exclusions. These are the most common. Exclusions in a life insurance policy could include:

- The ***War* (or Military Service) *Exclusion*** excludes coverage if death is a ***result of war,*** whether declared or undeclared. Its main purpose is to control adverse selection, because if a war breaks out, people entering the military would likely start applying for life insurance.
- ***Aviation Exclusion*** excludes coverage if death occurs due to flying as a passenger or pilot on a ***non-commercial flight***. The insured would be covered if flying as **a fare-paying passenger on a regularly scheduled commercial airplane**.
- ***Hazardous Occupation and Hazardous Hobby Exclusion***
- ***Foreign Travel or Foreign Residence***

Special Note: Should an insured die from a cause or situation which is "**excluded**" in the policy, no death benefit will be paid, **nor will there be any refund of paid premiums**.