Life Insurance Basics

What is life insurance?

Life insurance is a contract binding a life insurance company to compensate a beneficiary for the death of a person insured. If the insured dies the company will provide a cash payment to the beneficiary. Life insurance is used to protect the economic value of a human life with regards to those who may be financially dependent upon it.

Uses of life insurance

Life insurance has many uses for both individuals and businesses. Some common uses include:

Individual Uses

- **Funeral** - Life insurance proceeds can ensure that there is enough money for proper funeral and burial expenses.
- **Debt** - Personal bills, credit card debt, student loans, and personal notes can be covered by life insurance in the event of an individual's death.
- **Mortgage Protection** - The proceeds of a life insurance policy can pay off the balance of a mortgage or provide an income stream to pay monthly mortgage or rent payments.
- **Income Replacement** - In the event of an individual's death, life insurance proceeds can provide a supplemental income stream to ensure that the surviving family members are able to maintain the same standard of living.
- **Education** - Life insurance proceeds can ensure that the education costs of the insured's children are covered.
- **Taxes** - Federal estate and state inheritance taxes can be pre-funded using life insurance to preserve the value of an estate.
- **Wealth Transfer** - Life Insurance products designed to create and transfer wealth most favorably to the next generation. Some money is to Live On and some is to Leave On… for the money you wish to Leave On, this is the best way to do it.
- **Donations/Gifts** - An individual can use a life insurance policy to fund a donation to a charity or leave a gift to a family member.

Business Uses

- **Key-Person** - A life insurance policy can be used to protect a business from the loss of income and profits caused by the death of a key employee.
- **Business Continuation** - Life insurance can be used to fund a buy/sell agreement or stock redemption plan to enable a partner or group of employees to buy the business interest of a deceased partner.
- **Business Loans** - Life insurance protection on a key employee or business owner can be used to pay off the debts of a business in the event of that individual's death.
- **Employee Benefits** - Life insurance protection for employees is commonly included in company employee benefits plans.

Determining your needs

There is no magic formula to determine how much life insurance you should have; however, there are a number of factors that should be considered when estimating how much life insurance you should carry. They include:

- **Final Expenses** - These could be unpaid hospital bills, funeral expenses, unpaid debts, probate costs, and estate and inheritance taxes.
- **Readjustment Fund** - This may be used to cushion the immediate lifestyle adjustment that a family must make when a loved one dies. The family may be forced to move, or the surviving spouse might have to look for a new job. In addition, a working spouse may find it difficult to return to work immediately after the death of a partner. The readjustment fund allows for adequate bereavement due to loss.
- **Supplemental Income** - After the readjustment period, there should be a consistent income stream to help pay for the family's living expenses, such as mortgage payments, monthly bills, and daycare.
- **Educational Funds** - Adequate funds should be available for the children's education. This might include elementary school, high school, and college.
- **Retirement Fund** - There should also be adequate funds available to ensure that the spouse can retire comfortably.

These are some factors that you should consider carefully when estimating how much life insurance you need. Everyone's life insurance needs are different but, in general, an individual's needs are greatest from the time they start their careers or a family until they reach retirement, at which time many individuals' needs for life insurance diminish. It is important to remember that you should review your life insurance needs annually to account for changes in your family's lifestyle.

Types of life insurance

Term Life Insurance

Term life insurance provides protection for a specified period of time. A death benefit is paid to the beneficiary if the insured dies within a specified period of time while the policy is still in force. Many term life insurance plans can be converted to permanent life insurance plans without evidence of insurability.

Level premium term life insurance has premiums which remain level over a specified period of time. These plans have premiums that remain level for a period of 5, 10, 15, 20, 25, and 30 years. After the initial level period expires, the annual premium increases each year, subject to a guaranteed maximum.

In general, term life insurance is suitable when your life insurance needs are temporary or your life insurance needs are long-term but your budget does not permit the higher premiums of permanent life insurance.

What is Return of Premium (ROP) Term Life Insurance Policy?

A return of premium term life insurance policy typically offers a level death benefit with fully guaranteed* level premiums for the first 15, 20, or 30 years, though this may vary by company and state. Under the return-of-premium feature, the cumulative premiums paid, not including substandard and rider charges, will be returned at the end of the level term period if the policy is in force at that time. Often, a portion of the cumulative premiums will be returned upon surrender after the policy has been in force for a specified number of years. Most return of premium life insurance policies allow for conversion to permanent insurance offered by the same company during the covered period without further evidence of insurability. *guarantees subject to the claims-paying ability of the underwriting insurance company

Whole Life Insurance

Whole life insurance is permanent life insurance and provides protection for life. As long as premiums are paid, a death benefit is paid to the beneficiary. The premiums for whole life insurance policies are designed to remain level over time. In addition, these policies accumulate cash values on a tax-deferred basis. The rate of return on whole life insurance cash values is dependent upon a number of factors including the results of an insurance company's investment performance. Cash values can be used for a variety of options:

- The policy can be surrendered at any time for the cash surrender value.
- The policy owner can take out a loan and use the cash value as collateral.
- The policy can be changed to a reduced death benefit amount that is paid up.
- The cash values may be used to pay premiums for a certain period of time.
- The cash surrender value can be used to supplement retirement income.

The cash values of whole life insurance policies may be affected by a life insurance company's future performance. Some factors that influence a life insurance company's performance are expenses, mortality experience, and investment performance.

Universal Life Insurance

Universal life insurance is permanent life insurance. As long as premiums are paid, a death benefit is paid to the beneficiary. These policies are different from whole life insurance policies because they offer the policy owner some flexibility to change the premium payments and death benefit. The death benefit may be increased subject to insurability or decreased, and the premiums can also be increased and decreased as well as skipped. Universal life insurance policies may be purchased with one of two different death benefit options. One is a level death benefit and the second is an increasing death benefit. Although premium payments are flexible, a universal life policy will usually have a target premium which is the suggested annual premium payment. The target premium for some companies is sufficient to keep the policy in-force to age 100; however, this is not guaranteed. Universal life insurance policies also accumulate cash values on a tax-deferred basis. These cash values tend to be interest-sensitive and can be used for a variety of options:

- The policy can be surrendered at any time for the cash surrender value.
- The policy owner can take out a loan and use the cash value as collateral.
- The policy can be changed to a reduced amount paid-up whole life policy.
- The cash values may be used to pay premiums for a certain period of time.
- The cash surrender value can be used to supplement retirement income.

Universal life insurance policies are valuable because they can provide permanent protection and accumulate cash values that can be used for emergencies or for meeting specific objectives. For those who prefer flexibility, universal life insurance provides more options than whole life insurance.

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Variable Life Insurance

Variable life insurance is permanent life insurance and provides protection for life. As long as premiums are paid, a death benefit is paid to the beneficiary. The premiums for variable life insurance policies are designed to remain level over time. In addition, these policies accumulate cash values on a tax-deferred basis with the potential for higher rates of return than traditional whole life policies. Variable life insurance policies' cash values vary with the investment results of funds chosen by the policy owner. The policy owner is given a choice of investment options which are usually stock, bond and money market funds. Unlike whole life insurance policies which have guaranteed cash values, the cash values of variable life insurance policies are not guaranteed. The cash values of variable life insurance policies can be used for a variety of options:

- The policy can be surrendered at any time for the cash surrender value.
- The policy owner can take out a loan and use the cash value as collateral.
- The cash values may be used to pay premiums for a certain period of time.
- The cash surrender value can be used to supplement retirement income.

Variable life insurance policies are valuable because they provide permanent protection and may accumulate cash values; however, these policies carry more risk than traditional whole life insurance policies. Individuals considering purchasing a variable life insurance policy should be experienced investors in equity investments.

The cash values of variable life insurance policies may also be affected by a life insurance company's future performance. Some factors that influence a life insurance company's performance are expenses and mortality experience.

Variable Universal Life Insurance

Variable universal life insurance is permanent life insurance. As long as premiums are paid, a death benefit is paid to the beneficiary. These policies are different from variable life insurance policies because they offer the policy owner some flexibility to change the premium payments and death benefit. The death benefit may be increased or decreased, and the premiums can also be increased and decreased as well as skipped. Variable universal life insurance policies may be purchased with one of two different death benefit options. One is a level death benefit and the second is an increasing death benefit. In addition, these policies accumulate cash values on a tax-deferred basis with the potential for higher rates of return than traditional whole life policies. The cash values of variable universal life insurance policies vary with the investment results of funds chosen by the policy owner. The policy owner is given a choice of investment options which are usually mutual funds which invest in stocks and bonds. Unlike universal life insurance policies which have guaranteed cash values, the cash values of variable universal life insurance policies are not guaranteed. The cash values of variable universal life insurance policies can be used for a variety of options:

- The policy can be surrendered at any time for the cash surrender value.
- The policy owner can take out a loan and use the cash value as collateral.
- The cash values may be used to pay premiums for a certain period of time.
- The cash surrender value can be used for retirement income.

Variable universal life insurance policies are valuable because they can provide permanent protection and may accumulate cash values; however, these policies carry more risk than traditional universal life insurance policies. Individuals considering purchasing a variable universal life insurance policy should be experienced investors in equity investments.
The cash values of variable universal life insurance policies may also be affected by a life insurance company's future performance. Some factors that influence a life insurance company's performance are expenses and mortality experience.

Second-to-Die or Survivorship Life Insurance

A second-to-die life insurance policy insures the lives of two people, typically a husband and a wife. The death benefit is not paid to the beneficiary until the death of the second insured. These life insurance policies are generally available as either whole life insurance or universal life insurance policies, and premiums are often less expensive than buying two life insurance policies.

Second-to-die life insurance policies are effective tools often used by wealthy individuals in estate planning. They can be used to pay for estate taxes. By removing the proceeds of a life insurance policy through the use of gifting policies and third party ownership, a life insurance policy can be used to pay for estate taxes. Careful planning by your tax and legal counsel, coupled with a properly structured second-to-die life insurance policy, can help you preserve your net worth.

Beneficiary designation

A beneficiary is a person or entity named to receive a portion of the death benefit of a life insurance policy. The owner of a life insurance policy may name multiple beneficiaries, and most insurance companies permit the policy owner to change beneficiaries.

There are two types of beneficiaries: primary and contingent. A primary beneficiary has the first claim to the proceeds of a life insurance policy should the insured die. There may be more than one primary beneficiary and the proceeds do not have to be shared equally. The policy owner of a life insurance contract may also name a contingent or secondary beneficiary. The contingent beneficiary has a claim to a portion of the death proceeds should the primary beneficiary(s) be removed or die prior to the death of the insured. There may also be more than one contingent beneficiary.

Many individuals designate a spouse as the primary beneficiary of their life insurance policy and the children as contingent beneficiaries. You should consult with an estate-planning attorney prior to making a minor child a beneficiary of a life insurance policy. In addition, anyone contemplating making their estate the beneficiary of their insurance policy should use extreme caution and consult with an estate planning attorney prior to doing so.

Settlement options

The life insurance policy owner may designate a specific settlement option to be paid upon his or her death. If the policy owner does not choose a specific option, the beneficiary(s) will be given a number of choices. These usually include:

- **Lump Sum Payment** - The death proceeds of a life insurance policy are paid to the beneficiary(s) in one lump sum payment.
- **Fixed Period Payments** - The death proceeds of a life insurance policy are paid to the beneficiary(s) for a fixed period.
- **Life Income with Installments Certain** - The death proceeds of a life insurance policy are paid to the beneficiary(s) in installment payments through a certain period. After the certain period, payments will continue to be made throughout the beneficiary's lifetime but the payment may vary from the payments during the certain period.
- **Interest Payments** - The death proceeds of a life insurance policy remain with the insurance company and the company pays the beneficiary interest payments.
- **Fixed Installments** - The death proceeds of a life insurance policy are paid to the beneficiary(s) in fixed installments until the proceeds and interest on the unpaid balance of the proceeds are exhausted.
- **Single Premium Annuity** - The proceeds of a life insurance policy are used to purchase a single premium annuity from the insurance company.

Where do we go from here?

1. Do it yourself: figure out what kind of insurance is right then go online and find the right company.

2. Let us help: North Star can help you determine what kind of life insurance and level of coverage is right for your particular circumstance. We work with over 20 insurance companies to get you the best coverage.

Contact us today to get started!
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Insurance policies have exclusions and/or limitations. The cost and availability of life insurance depend on factors such as age, health and the type and amount of insurance purchased. As with most financial decisions, there are expenses associated with the purchase of life insurance. Policies commonly have mortality and expense charges. In addition if a policy is surrendered prematurely, there may be surrender charges and income tax implications. Guarantees are based on the claims paying ability of the insurance company.