VERMONT

DEPARTMENT OF FINANCIAL REGULATION

# Consumer's Guide to Purchasing Life Insurance

## Introduction

When a death occurs in a family, those who are left may suffer financial loss and hardship. Life insurance is designed to ease those difficulties. Its primary purpose is to protect the surviving members of a family or other dependents against the loss of an individual's income or services. A life insurance policy is a legal agreement between you and an insurance company that guarantees the payment of a death benefit to your chosen beneficiaries in exchange for the payment of a premium by you.

To help you decide if you should buy life insurance, think about your family situation and what would happen if you died tomorrow. Would there be enough money available for medical and funeral costs? Does your spouse have a separate income that could pay for food, clothes, and household bills? Do you have any debts that would be difficult or impossible for your survivors to repay? Do you have children who will need financial assistance for their education? Are you responsible for your parents' care?

## 1. How can this guide help you?

Today, there are many more kinds of life insurance products, coverage, and payout options available to consumers than in the past. You do not have to become an expert before you buy life insurance, but it's important to be an informed consumer and know your options. If you are not familiar with the life insurance products in the market these days, this guide will help you understand what they are, and how they differ. This guide also aims to steer you clear of potential fraud, unsuitable products, and other consumer abuses. It covers your consumer rights under Vermont law, where to get answers to questions and how to file a complaint. The more you know up front, the better armed you will be to avoid costly mistakes.

## A Preliminary Note about Individual vs. Group Life Insurance

Please note that this guide focuses on individual life insurance. Individual life insurance can take many forms and is almost always paid for entirely by the purchaser – that is, paid for by you. One of the advantages of individual life insurance is that you are free to choose exactly the kind of coverage and whatever special features you want or need. If you are an employee of a company or a member of a union or association, chances are good that you already have some type of life insurance protection offered through a group life insurance policy purchased by your employer, union, or association. If so, you have little or no control over the plan design or benefits provided – thus very little "choice" to worry about. Also, in many cases the amount of coverage provided by a group life insurance policy is limited and may not be sufficient to meet your dependents' needs. In that case, you may want to consider supplementing your group life policy with a policy of individual life insurance. Finally, group life insurance may terminate when you leave your employer, union, or association. This is another reason why it may make sense to consider purchasing individual life insurance.

## 2. Identifying Your Needs

When you buy a life insurance policy, you select an amount of money that will be payable at the time of your death and you name the person or persons who are to receive that money (these are known as your "beneficiaries"). You may also have the right to determine whether that money will be paid in a lump sum or in a series of payments. All these choices depend on what you want the insurance to do for you and your dependents. Most people buy life insurance to provide financial security for their families upon the death of the insured person. If this is your

reason, the first step in calculating how much insurance to buy is to identify your dependents' likely financial needs. If you are married, in a civil union, or have a significant other, you will want enough coverage to minimize your spouse's or partner's financial need after you are gone. If you have dependent children, you may want to help pay for their college tuition and other expenses. If your annual living expenses such as a mortgage on your home, personal or car loans, or property taxes are high, you will need more insurance than someone whose home mortgage is fully paid for. You may also want enough coverage to ensure that your dependents do not have to pay for your final expenses, such as hospital bills and burial costs. Next, you should make a list of all the sources of income and assets your family would have if they were without you right now. This list can include cash in checking and savings accounts, the value of any stocks and bonds you own, your home equity, and benefits from social security. Check to see if you already qualify for group insurance. If you do, consider taking advantage of it and adding the face amount to your current assets. Do not forget to include the ability of other members of your family to earn a living.
The final step is to compare the total of your income and assets with the total of your dependents' anticipated expenses. Ideally, you should buy enough life insurance to make up the difference between what your dependents would have if you died today and what they would need. However, it is important to buy only as much life insurance as you can afford. Buying a policy you cannot afford and then losing it because of your inability to pay the premiums is good money thrown away. One final consideration: the amount of insurance coverage you need to protect you and your family while you are young is different from the amount you need later in life. If you already have a life insurance policy that you bought years ago, you ought to take another look at the policy as well as at your own needs. Perhaps your circumstances have changed dramatically since the policy was purchased. You may need to purchase additional insurance or may be able to reduce coverage to meet your current needs. Review your life insurance policy regularly to make sure it still meets your needs.

## 3. The Four Basic Types of Life Insurance "Pros" and "Cons"

### Term Life

Term life insurance covers you for a set period of time, called the policy term, which begins and ends on specific dates. For example, a ten-year policy term would provide coverage for ten years. Benefits will be paid only if you die within that time. If you live past the end of the term and do not renew the policy, the policy expires; it will then have no cash value and pay no benefits. Generally, term insurance offers the largest amount of pure insurance protection for the lowest premium. However, because your risk of dying increases as you get older, your premium will generally increase each time you renew the policy and eventually the policy may become unaffordable.

### Pros:

Often provides the greatest amount of insurance for the lowest amount of premium.
Flexible policy period (can usually buy for 1, 10 or 20-year term).
The death benefit is not taxed.
May be convertible to whole life or other type of permanent insurance without evidence of insurability.

### Cons:

Is more difficult to buy and more expensive if purchased when you are older, because the odds of dying increase as you age.
Once the term ends, you must renew or lose your insurance. The premiums on the renewal policy are likely to be much higher than the premiums on your original policy, especially if your health has deteriorated.
Has no cash value and does not pay interest or dividends.

## Whole Life

Whole life insurance is a kind of permanent insurance that stays in force for your whole life (unlike term insurance), if you pay the premiums. Whole life insurance combines a death benefit with a cash savings feature. Part of each premium goes to pay for the death benefit, part to pay the insurer's expenses and profit, and part is placed in an account that accumulates interest over time. You may borrow against the policy's cash value by taking a policy loan to meet unexpected expenses. If you do not pay back the loan and the interest on it, the amount you owe will be subtracted from the death benefits when you die. If you decide to surrender your policy, the company will pay you the cash value accumulated up to that point, less the amount of any unpaid policy loans and interest. In the early years, the premiums for a whole life policy are likely to be much higher than they would be for a comparable amount of term insurance because you are also purchasing the savings feature, but if you continue the policy into middle age and beyond, when insurance becomes more expensive, the premiums are often lower than they would be for a comparable term policy.
Be Careful: Because interest and dividends accumulate tax free inside a whole life policy, whole life insurance is sometimes marketed as a good way to save for retirement. However, whole life policies often carry higher commissions and fees than other investments (such as no-load mutual funds or money market funds), and these higher costs can eat into the policy's annual return. If tax-advantaged retirement savings are your goal, it may make sense to consider other investment options (such as increasing your contributions to an IRA or to your company's 401(k) plan) before purchasing a whole life policy. Also, since much of your premium during the first few policy years goes to paying the commission of your agent (also known as a producer), the cash value of a whole life policy builds slowly in the beginning. For this reason, it is not a good idea to buy a whole life policy unless you can afford to keep it for the long term.

### Pros:

Premiums generally don't increase with age
Protects you your entire life (if kept) and is not subject to non-renewal
Cash values are guaranteed, and you can take out a loan against the policy or surrender it for cash
Cash values grow on a tax-deferred basis; you pay taxes on interest and earnings only when they are withdrawn
The death benefit is not taxed.

### Cons:

Higher cost initially than term life
Long term commitment required
Dividends can be reduced by low interest rates

Cash value accumulates slowly during the first few policy years, so you may lose much of your money if you surrender the policy within 3-5 years from the time of purchase.

## Universal Life

Like whole life insurance, universal life offers both permanent insurance protection and a cash value element. With universal life, your premium is placed into an investment fund managed by the insurance company. Each month, the cost of a term insurance policy and the insurer's administrative costs are deducted from that account. Unlike whole life insurance, where the rate of return on your cash value is tied to the insurer's long-term investment portfolio, with universal life your cash value earns interest at current market rates. This means that if market interest rates rise, the cash value of your policy will increase, and you may be able to pay lower premiums or skip several premium payments altogether. On the other hand, if interest rates decline, you may have to pay more than your planned premium to keep the policy in force. Universal life insurance also offers you more flexibility than either term life or whole life insurance. For example, within certain limits, you can increase or decrease the amount of premium payment, increase, or decrease the death benefit, and change the frequency of premium payments. As with whole life insurance, you can take loans against the cash value of a universal life policy, but the death benefit is reduced by the amount of any outstanding loans and interest.

## Pros:

Maximum flexibility: policyholders can vary the amount and timing of premium payments, and the amount of coverage
Investment component earnings are tax-deferred
Cash value: you can take out a loan against the policy or surrender it for cash
The death benefit is not taxed.

## Cons:

The cash value of the policy and the size of the premiums are closely tied to prevailing interest rates and may fluctuate according to the general financial climate
Premiums can rise as you get older
Because administrative costs are front-loaded, cash values build slowly during the initial policy years and you may lose much of your money if you surrender the policy within 3-5 years from time of purchase.

## Variable Life Insurance

Variable life insurance is a kind of permanent insurance that was developed to address the adverse effects of inflation on death benefits and cash values. With a variable life insurance policy, your death benefits and cash values vary based on the performance of the assets in which your premium payments are invested. You will generally be offered a variety of investment options, such as stock funds, money market funds or bond funds. If the funds earn profits, the amount of your death benefit goes up. If the funds lose money, your death benefit amount goes down. If you decide to cancel the policy, you will be paid the policy's cash value on the day you cancel it. Unlike whole and universal life insurance, which guarantees minimum cash value if you surrender your policy, the cash value of a variable life insurance policy may reduce to zero. If that happens, you will get nothing back if you cancel the policy. Some variable

life insurance policies offer a guaranteed minimum death benefit; however, you may be required to pay extra for that feature.
Be Careful: Because of the investment risk, variable life is both an insurance product and a securities contract. In addition to having a Vermont insurance license, producers who sell variable life must be registered representatives of a broker-dealer licensed by the National Association of Securities Dealers.

### Pros:
Allows you to participate in a variety of investment options and "control" your insurance.
Earnings are not taxed until you surrender the policy.
If your investments perform well, your death benefits and the cash value of your policy may increase substantially.
The death benefit is not taxed.

### Cons:
If your investments lose money, the death benefit may decline.
Administrative costs tend to be high and may reduce your overall return.
Although you can surrender the policy for cash, your ability to borrow against the cash value may be limited.

## 4. Ways to Buy Insurance, and How to Protect Yourself Insurance
You can purchase individual insurance from an insurance company, an agent (also known as a producer), through the mail, or over the Internet. When buying life insurance, you should use the same care that you would when making any sizeable purchase. Shop carefully because policies and plans differ in cost and coverage.

### Choosing a Company
When you buy a life insurance policy, you want to be sure that the company you are dealing with is a reputable one that will be around to protect your loved ones when the need arises. Since you may live for many years after purchasing a life insurance policy, one important factor to consider in choosing a company is its financial strength. You can get information about a company's financial strength from your insurance agent. There are also several commercial rating services that evaluate the claims-paying ability and financial strength of insurance companies. Two of the best known are A.M Best Co. and Moody's Investor Service. Ratings issued by these and other rating services are usually available at your local public library. You can also find the websites of rating companies on the Internet. For a menu with links to most of the top rating companies, go to the Insurance Division website: [www.dfr.vermont.gov/industry/insurance](http://www.dfr.vermont.gov/industry/insurance) and click on the link to "Financial Rating Companies." Check the rating date to be sure the information is current. Another important factor to consider is whether the company you are buying life insurance from is licensed to do business in Vermont. Being licensed means that the company's financial condition has been reviewed and found to be satisfactory by the Vermont Insurance Division or by the company's home-state regulator. There are currently over 360 companies authorized to sell life insurance in Vermont. If a company is not licensed in this state, you will not be protected by the Vermont Life & Health Insurance Guaranty Fund if the company fails. To find out whether an insurance

company is licensed in Vermont or has a history of financial problems, you can call Insurance Company Licensing at (802) 828-2470 or e-mail dfr.complic@vermont.gov.

## Choosing an Agent

Some companies employ agents or sales representatives who sell their policies. Most agents are knowledgeable, trained insurance professionals and all of them must pass a licensing exam to sell life insurance to Vermonters. A good agent will take the time to make sure you really understand what you are buying and will answer all your questions or give you written material if requested. Beware of anyone who pressures you into making rushed decisions, dodges questions, or cannot explain something to your complete satisfaction. If you use an agent, make sure the agent is licensed. You can check the status of an agent's license by calling the Vermont Insurance Division's Producer Licensing Section at (802) 828-3303 or by e-mailing them at dfr.producerlicensing@vermont.gov. Beware of solicitations from people you do not know. And don't assume that just because you know someone that it's wise to buy what they are selling. The Insurance Division often receives complaints from people who made the mistake of blindly trusting a friend selling insurance or someone referred to them by a family member. Also, never agree to anything over the phone. Always ask for information in writing first and always check out the seller.

## Exercise your right to a "Free Look".

Under the law, you have the right to return the policy to the insurer, for any reason -- and get your money back -- if you do so within the required time periods. If the new policy you buy replaces an older policy you bought earlier, you have 30 days to return it free of charge. If the new policy does not replace an older policy, you have 10 days. During this period, read the policy carefully. If you decide you do not want to keep it, you can return it for a refund of the premium you already paid, and the policy will be considered void from the beginning.

## A Note of Caution about "Replacements"

Be cautious about "replacing" an existing life insurance policy with a new one. While it is important to review your policy periodically to make sure that it still meets your needs, switching life insurance policies can be expensive. This is because the cash value of a whole or universal life policy tends to build up faster as the policy gets older, and you may incur additional startup costs, such as sales expenses and commissions, to purchase the new policy. Also, with a replacement policy, you may find that you are subject to a new "contestability" period. This is the two-year period after a life insurance policy is issued during which the company can refuse to pay a claim in case of suicide or misrepresentation on the application. If you are considering a replacement policy, you should ask for a written comparison of the replacement policy with the original. You should also consider contacting your present agent or insurer before you decide to switch. They may be able to meet or beat the offer of the replacing insurer with new or updated products that they have available now.

## 5. The Application Process

When you buy an insurance policy, you must fill out an application form, and you may be asked to take a medical exam. The insurance company may check the statements you make on the application to be sure that all the information you have given is accurate. The completed application becomes a permanent part of the legal contract between you and your insurance company. From that application, the company will decide if it will insure you, and at what premium.

### If you provide inaccurate information:

There could be consequences for submitting an application that contains misstatements or leaves out information that would have caused the company to deny you coverage. This might leave you or your beneficiary with just a refund of your premiums, rather than the expected face amount of the policy. So, pay careful attention to your answers on the application. If an agent fills out the application for you, check the form carefully to be sure that all the information is correct and complete. You will be held responsible for full and truthful answers.

## 6. How Do I Get More Information?

The Vermont Insurance Division regulates insurance industry activities in Vermont and protects consumers from fraud and abuse. The following telephone numbers provide useful information and assistance to Vermont insurance consumers:

The Insurance Division maintains records of complaints against insurance companies and agents. To find out whether a company or an agent has a history of consumer complaints, you can contact the Insurance Division's Consumer Complaint Section at 1-800-964-1784 or e-mail dfr.insuranceinfo@vermont.gov.

The Insurance Division also conducts routine investigations called market conduct examinations to determine if insurance companies are complying with Vermont law and treating consumers in a fair and equitable manner. To find out whether the Division has conducted a market conduct examination of a particular insurance company, contact the Division's Market Conduct Section at 1-802-828-4843. You can also view the Division's market conduct reports on the web by going to dfr.insuranceinfo@vermont.gov and clicking on Market Conduct Examinations.

To speak with someone in the Insurance Division who may be able to answer your general questions about life insurance, call 1-800-964-1748.

### The National Association of Insurance Commissioners

The National Association of Insurance Commissioners (NAIC) is an organization of insurance regulators from all 50 states, the District of Columbia, and the U.S. territories. The NAIC website has a wealth of unbiased consumer information and consumer resources on its consumer information portal (featured on www.naic.org) including company financial information and complaint data for all the states that a company does business in.

### Your local library:

Most libraries have information about insurance companies, for example, the ratings given by independent appraisal companies (A.M. Best, Standard & Poor, etc.) for an insurance company's financial strength, claims paying ability, and overall financial health.

## 7. How Do I File a Complaint?

Before you make a complaint, it may be a good idea to call the Insurance Division's Consumer Assistance Line (1-800-964-1784) to discuss your problem and determine whether a formal complaint, or some other intervention, would best solve your problem. Some consumer problems arise out of misunderstandings that can be cleared up without taking the time to file a formal complaint. To file a complaint, you can call and request a complaint form by U.S. mail, or you can download one from the Insurance Division's website https://dfr.vermont.gov/industry/insurance. When you submit a complaint, it is very important to attach copies of any related documentation that you have (such as a copy of a claim, a claim denial or proof of payment.) However, if you do not have all the documents involved, don't let that stop you from asking for help. In some cases, we can obtain records directly from insurance companies.

## 8. Questions Vermonters Often Ask

### Q. Where can I buy a life insurance policy?

A. Individual life insurance can be purchased directly from an insurance company, through the mail or from an insurance producer. Insurance may also be offered over the Internet, but you will usually have to sign a paper application as well. Group life insurance may be available through your employer or through a group to which you belong.

### Q. Do I have time to think about my purchase?

A. Yes. Make sure you understand the policy before you buy it. But, you will also have at least ten days after the policy is delivered to you to return the policy. This is called a free look period. If you do this within ten days (30 days if the new policy replaces an existing policy), the company will return all the premiums you have paid.

### Q. How can I buy the most insurance for the least cost?

A. Individual Term Life Insurance usually gives you the most insurance for the least amount of money. However, a group policy, if available through your employer, is often cheaper than an individual policy. Unlike individual insurance, with a group policy you usually do not have to take a medical exam or answer health questions if you apply during the initial enrollment period.

### Q. Will I need life insurance when I retire?

A. It depends on your individual financial circumstances. Social Security and some retirement plans available through employment may provide a continuing income for dependents after a retiree's death. Some consumers can use the accelerated death benefit rider available in some life insurance policies to cover nursing home costs, but this will usually not provide the same amount of protection as long-term care insurance.

### Q. Can a company refuse to pay a claim in case of suicide or if I do not tell the truth on an application?

A. In the first two years after you buy a policy, the company can refuse to pay if the cause of death is suicide, or if you have made a material misrepresentation in the application. A "material misrepresentation" means you did not tell the truth about a situation or medical condition that would have caused the company to deny you insurance if they had known the truth. If you understate your age to obtain a more favorable premium, the Insurance company will reduce the death benefit to be equal to what your premiums would have purchased at the correct age. After the policy has been in force for two years, the company cannot contest the claim if you have paid the premiums. This is called "incontestability." If you change companies or policies, you may be required to go through another two-year period in which the company could deny a claim because of suicide or a material misrepresentation in the application.

### Q. What happens if I miss a premium payment?

A. During the grace period, which is the 30-day period after the date your premium is due, you can pay your premium with no interest charged. If you die during the grace period, your beneficiaries will receive the death benefit of the policy minus the premium owed. If you do not pay the premium within the grace period, your policy will lapse. That means that you have ended your relationship with that insurer and, if you were to die, your beneficiaries would not get any death benefits. However, in some cases the law allows you to reinstate a lapsed policy for up to three years. To reinstate a lapsed policy, you would have to pay all overdue premiums with interest, plus reinstate or repay any loans you have taken against the policy. You might also be required to fill out a new health questionnaire or have a medical exam.

## 9. Glossary of Key Insurance Terms

### Accelerated Death Benefit

This is an optional feature that pays you part of your insurance benefit while you are still alive, usually if you are terminally ill or confined in a convalescent care home. You may have to pay extra for this feature.

### Administrative Fees

An amount deducted from a life insurance policy premium to pay the costs of marketing or administering the policy.

### Agent (Producer)

An insurance company representative licensed by the state that sells insurance policies and provides service to the policyholder on behalf of the insurer.

### Amendment

An attachment to a life insurance policy that modifies certain policy terms.

### Application

The form you must fill out to buy a policy.

### Beneficiary

The person or entity designated to receive the death benefits from a life insurance policy when the insured person dies.

### Cash Surrender Value

The amount of cash that is due the policy owner who surrenders a life insurance policy. Surrendering the entire value, with termination of all insurance benefits, is often called "cashing out." Term life policies usually do not have a cash surrender value.

### Churning

A fraudulent practice in which insurance producers mislead consumers into giving up the cash value or taking loans against current life policies to buy new policies with a new company or with the same company. Since producers receive a commission when a new policy is purchased, the producer "churns" policies to make more profit.

### Commission

The money paid to an insurance producer for selling an insurance policy. A commission is almost always calculated as a percentage of the premium and is paid to the producer by the insurance company.

### Dividends

Some cash value policies give you money back when the insurer has made a profit. However, there are no guarantees that you will get money back or how much it will be. A policy that pays dividends is called a "participating" policy.

### Evidence of Insurability

A signed health questionnaire or a physical examination, depending on a company's requirements.

### Face Value

The initial amount of death benefit provided by the policy as shown on the front page of the contract. The actual death benefit may be higher or lower depending on the options selected, outstanding policy loans
or premium owed.

### Free-Look Period

The 10-day period after a life insurance policy is delivered during which the policy owner may review it and return it to the company for a full refund of the initial premium. The free-look period is 30 days when the new policy replaces an existing policy that you own.

### Grace Period

The 30-day period during which a policy remains in force after the premium is due but not paid. The policy lapses as of the day the premium was originally due unless the premium is paid before the end of the 30 days or the insured person dies during the grace period.

### Guaranteed Insurability Rider

A rider attached to a life insurance policy which permits you to buy additional insurance at one or more specified "option dates" without providing new evidence of insurability at that time.

### Paid-Up Additions

Additional life insurance purchased with policy dividends. No additional premium payments are needed for paid-up additions.

### Policy Loans

A loan from your policy's cash value.

### Policy Owner
The person who owns an individual life insurance policy. This person may be the insured, the beneficiary, or another person. The policy owner usually is the one who pays the premium and is the only person who may make changes to a policy.

### Premium
The amount of money you pay to buy a life insurance policy. There are many ways you can pay premiums, for example, as a single lump sum payment or as a series of installment payments.

### Replacement
A replacement happens when a consumer uses some or all the value of life insurance that the consumer currently owns to buy a new life insurance policy contract.

### Rider
A written amendment attached to an insurance policy expanding or limiting the benefits otherwise payable under an insurance policy.

### Surrender Charges
Charges that are deducted if your life insurance policy is cashed in (surrendered). The amount of the surrender charges varies widely among insurance companies and may change over the life of the policy.

### Vermont Life and Health Insurance Guaranty Association
An association created by Vermont law that helps pay the claims of financially impaired life insurance companies.

### Waiver of Premium
A waiver of premium rider is a special feature you can purchase which provides that your policy will stay in force if you become totally disabled. Premiums are waived as long as your disability continues, and the policy benefits continue just as if you had paid the premiums. You are responsible for notifying the insurance company if you become disabled.