

## *Term Life Insurance*

### **Learning Objectives**

*An understanding of the material in this chapter should enable you to do the following*

- 3-1. Describe the nature and features of term life insurance.
- 3-2. Explain the renewability and conversion provisions.
- 3-3. Describe why the period for renewability for term insurance is limited.
- 3-4. Compare term insurance variations and their usefulness.
- 3-5. Discuss methods for marketing to, prospecting for, and approaching life insurance prospects.

### **Chapter Outline**

WHO ARE TODAY'S LIFE INSURANCE BUYERS?	3.2
Male/Female Buyers	3.2
Senior Buyers	3.2
Term Insurance Buyers	3.3
Universal Life Insurance Buyers	3.4
Larger Policies: Fewer Sales and Larger Premiums	3.4
The Future	3.4
TERM INSURANCE	3.6
Nature of Term Insurance	3.6
Types of Term Insurance	3.15
Uses and Limitations of Term Insurance	3.22
MARKETING, PROSPECTING, AND APPROACH	3.30
Marketing	3.30
Qualifying Prospects	3.32
Motivating Prospects: What They Want and Do Not Want	3.33
Prospecting Methods	3.39
Approaching the Prospect	3.42
CHAPTER THREE REVIEW	3.43

Chapter 3 reviews the features of the life insurance policy and contract, focusing on term insurance. It then introduces a few of the main variations of these basic policy designs. The chapter concludes with a discussion of marketing to, prospecting for, and approaching prospects regarding life insurance products.

---

## **WHO ARE TODAY'S LIFE INSURANCE BUYERS?**

---

The following information was taken from a LIMRA International Study released in January of 2007 based on studies of life insurance sales in the United States in 2005 (2007, LIMRA International Inc., Individual Life Buyers in the United States).

Although the “average” individual life insurance buyer may not change much from year to year, there are many factors that affect who buys, what they buy, and how much they buy. These factors include the buyer's stage of life, gender and age, and product introductions, such as return-of-premium term and secondary-guarantee universal life, and life settlements. The following is a brief summary of demographic trends in life insurance purchases.

### **Male/Female Buyers**

Men purchase the majority of individual life sold in any given year. In 2005, males purchased 54 percent of the life insurance policies sold to adults (this number has not changed significantly since 2003). Men also purchased larger individual life insurance policies than women. Both genders increased their average policy size by approximately 25 percent, but the coverage amount for women is still 40 percent lower than the average coverage for men. Women are catching up, though. With the exception of buyers over age 64, coverage amounts for younger adult women are consistently closer to the amounts purchased by younger men.

On average, both male and female buyers of all ages purchased larger policies in 2005 than buyers did in 2003. This is especially true for the older buyers who tend to have more cash and are more likely to purchase larger universal life (UL) policies with guarantees. The emerging life settlement market may also have an impact.

### **Senior Buyers**

Seniors have generated a lot of interest over the last few years with regard to the life settlement market and guaranteed death benefit UL products that target this age group. While it is too soon to see the impact of life settlements on buyer demographics, changes have been seen in the senior market:

- While seniors purchased only 11 percent of the total individual life insurance policies sold in 2005, more than 20 percent of the policyholders who purchased UL policies were 55 or older (up from 12 percent in 2003). These older buyers accounted for two-thirds of the single premium UL policies sold in 2005. Policyholders likely have additional cash available to them at this age, as they often have higher incomes, less debt, and are generally not raising children.
- Seniors, a group inclined to reduce financial risks, are also more likely to purchase universal products with long-term secondary guarantees—hot products in 2005 (and today). In fact, over one-third of those who bought guaranteed UL products were over the age of 54, compared to less than 20 percent who bought other types of UL products.
- About one-third of policies bought by consumers aged 65 or over and one-quarter of sales in the 55 to 64 market were whole life (WL) policies. These WL policies tend to be significantly smaller than the UL policies seniors buy. In fact, more than half of older adults who purchased WL policies had an average policy size of \$10,000 or less (likely final expense coverage).
- Seniors represent only 7 percent of the total number of recurring premium WL policies sold. When looking at buyers over the age of 17, however, 18 percent percent of WL policies were purchased at age 55 or older. Still, seniors dominate single premium WL sales, representing half of single premium buyers and 71 percent of premium.

### **Term Insurance Buyers**

Term is most popular among buyers between the ages of 25 and 54. The majority of young adult buyers purchase some form of permanent coverage, because permanent insurance is very affordable for the youngest adults. The cost goes up with age and buyers have increasing demands on their cash flow, thus making term insurance more attractive. Term's share of policies purchased increases with age until buyers reach 44. After that, its market share starts to drop as older age groups tend to concentrate more on permanent insurance.

While 20-year term remains most popular, more term buyers are starting to choose 15-year and 30-year payment periods. Fourteen percent of the people who purchased term insurance in 2005 bought 30-year products, up from 9 percent in 2003. This was the largest percentage increase of all level premium periods.

Return-of-premium (ROP) term products have likely played a part in these trends. Of the companies able to provide their ROP sales data, just over 60 percent of ROP sales were sold with a 30-year premium payment period,

and more than one-third were sold with either a 15- or 20-year payment period.

### **Universal Life Insurance Buyers**

The recent increase in policy size is especially evident in UL products. The average size UL policies purchased by adult males and females in 2005 were significantly larger than in 2003 (60 percent and 45 percent larger respectively). This increase may be explained by the influx of UL products designed to provide long-term death-benefit guarantees and high early-cash accumulation.

Coverage for death-benefit-guarantee UL products is likely higher because these buyers tend to be older and more affluent. Those purchasing cash accumulation products may provide lower coverage amounts as policyholders put more money toward excess premium and not toward death benefit.

### **Larger Policies: Fewer Sales and Larger Premiums**

Although policy size is on the increase, only 6 percent of the policies purchased in 2005 provided the buyer with \$1,000,000 or more of coverage. Because of their size however, these policies account for almost half of new premiums.

The majority of buyers in this market purchased term insurance. The low cost of term allows policyholders to purchase larger policies which they might not be able to afford otherwise. One-third of the people who purchased at least \$5,000,000 of coverage in 2005 did so by buying UL products. While half of the buyers in this highest face-amount range purchased term insurance, UL represented over 70 percent of new annualized premium corresponding to these jumbo policies.

Because of the higher premiums associated with large policies, buyers in this market tend to be older than buyers in general. Insureds age 45 or older account for more than half of the policies with a face amount of \$5 million or more. Also, most people purchase life insurance for income replacement and income usually increases with age, which means older buyers have larger coverage needs. These buyers are also more likely to be male, as men represent a larger proportion of the high-income population.

### **The Future**

Life settlements will continue to impact buyer demographics in the near future. Through the efforts of companies and the potential regulation underway, however, the impact will likely lessen. According to a recent LIMRA survey, three-quarters of participating companies have either

discouraged or prohibited their agents from engaging in life settlement transactions.

The gap between the average size policy issued to males and females may continue to close, as it has been doing over the last few decades. The U.S. Department of Labor estimates that women will account for 51 percent of the increase in the labor force between 2004 and 2014. The gap between male and female salaries is also slowly closing; hence, women will need greater coverage amounts for income purposes and will be able to afford them.

**TABLE 3-1**  
**LIMRA Estimates of U.S. Individual Life Annualized New Premium\* Market Share by Product**

	Universal Life	Variable Life	Variable Universal	Term	Whole Life
1980	–	–	–	18	82
1981	2%	1%	–	19	78
1982	9	2	–	18	71
1983	18	2	–	15	65
1984	30	3	–	12	55
1985	38	3	1%	11	47
1986	35	3	3	12	47
1987	27	3	7	12	51
1988	26	1	7	13	53
1989	27	1	6	13	53
1990	26	1	6	13	54
1991	26	1	5	13	55
1992	24	2	7	13	54
1993	22	3	10	13	52
1994	22	3	13	14	48
1995	24	3	12	15	46
1996	22	3	17	17	41
1997	21	3	20	18	38
1998	20	3	25	19	33
1999	19	3	28	21	29
2000	18	3	33	23	23
2001	22	2	30	21	25

2002	27	1	23	22	27
2003	34	1	16	24	25
2004	37	1	15	23	24
2005	39	+	14	23	24
2006	39	+	15	23	23

Source: LIMRA estimates. 2007, LIMRA International, Inc. U.S. Individual Life Insurance Sales Trends, 1975-2006.  
 – Not applicable; + Less than one-half of a percent  
 \*Annualized premium excludes excess (dump-in) premiums on universal and variable UL plans; includes 10% of single premium and excludes large-case corporate-owned life insurance.  
 \*\* Preliminary estimates. Data for previous years have been revised

---

## TERM INSURANCE

---

There are several basic types of life insurance contracts: term, WL, UL, and endowment. The role of these contracts is to create a principal sum or estate, either through the death of the insured or through the accumulation of funds set aside for investment purposes. It should be remembered that the primary purpose of life insurance, regardless of the type, is to protect a family's financial future. Should the insured die, life insurance can help pay off mortgages, fund college educations, take care of final expenses, offset the loss of the insured's income and allow the family to continue its standard of living. In most cases, insurance proceeds pass to beneficiaries free of probate costs, legal fees, state inheritance taxes, and federal income tax. To the extent permitted by state law, insurance benefits are protected from claims of the insured's creditors. Benefits are generally paid promptly to beneficiaries through a convenient, interest bearing, no fee checking account, or through a pre-arranged settlement option that provides periodic payments until the proceeds are paid in full.

This section discusses term insurance contracts. We will cover permanent types of coverage in Chapters 4 and 5.

### Nature of Term Insurance

Sales of individual life insurance products have been relatively flat for several decades. While permanent insurance plans like UL and variable UL have seen periods of both sales growth and decline, term insurance products, for the most part, have experienced continual and steady growth.

The trend in product development has been for companies to offer more substantial premium guarantees. Initially, 5- and 10-year level premium periods were an alternative to the traditional yearly renewable term structures

(which are still offered by about a third of companies). The popularity of these plans with producers and consumers has led to longer level premium guarantees. Today, almost all companies offer both 10- and 20-year plans, while more than three-quarters also offer a product with a 30-year level premium guarantee. The 20-year contracts are the most popular.

Recently, ROP designs have become popular. Currently, more than 15 carriers market a ROP term product that allows for a full refund of premium paid if the policy reaches the end of the level term period without lapse or the payment of a death benefit. Most plans will also return a prorated portion of premium if the policy lapses after year 5. This concept is also seen in permanent products, especially ULs, due to their popularity in the term market.

### *Term Insurance Characteristics*

The two principal characteristics of term insurance are (1) the insured must die for any payments to be made; and (2) by definition, the contract expires at the end of the term. A term life insurance policy promises to pay a death benefit to a beneficiary only if the insured dies during the specified term.

Term insurance is the best solution for many situations, but not for others. It is pure death protection with little or no lifetime benefits. As with all insurance products, we must ask the following questions:

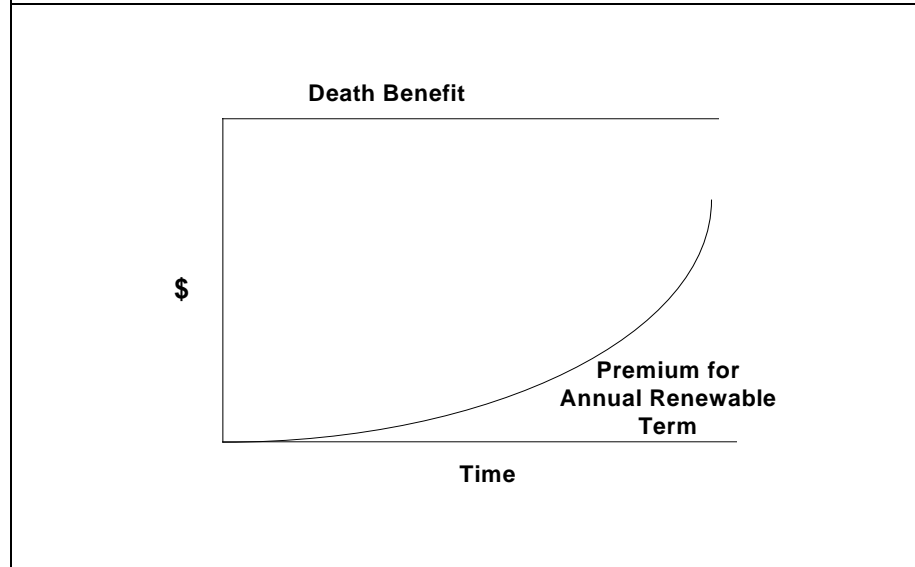
1. Will death protection alone meet the need?
2. Will the coverage last as long as the need?

These questions help us focus our analysis on selecting the appropriate coverage—the product must match the need.

In Chapter 1, we established that all life insurance policies have at least two costs, costs for mortality and costs for expenses. With term insurance, you pay only mortality and expense charges, nothing else. One-year term insurance is the best example of this concept. In Chapter 1 we also discussed the equivalence of the net amount at risk and life insurance. The actual life insurance amount a company has to pay for any type of life insurance is the net amount at risk. In this sense, all insurance is term insurance, because all insurance includes the cost of term insurance through the mortality charges for the net amount at risk. The difference between policies is really more a matter of how one will pay for the life insurance over time. With term insurance, the policy itself and the net amount at risk are virtually synonymous.

Initial premium rates per \$1,000 of coverage are lower for term insurance than for other life products issued on the same basis, since the period of protection is limited. Premiums for term coverage, however, can escalate rapidly as the duration of the policy lengthens.

**FIGURE 3-1**  
**One-Year Level Term.**



Many insurers and buyers treat term insurance as a commodity, an item that is essentially the same irrespective of the supplier and is therefore sought at the lowest price. As commodity profit levels are ordinarily low, many insurers' attempt product differentiation strategies and innovations. Term insurance buyers are generally a price-sensitive group, and consider term policies easily replaceable, since few penalties usually result from early termination. Consequently, term lapse rates are higher than lapse rates for other policies. Most recent experience indicates that term lapse rates have declined from the 15 percent–20 percent range in the early policy years to a more level pattern of about 10 percent per year, perhaps because of the trend towards longer-term durations.

Term insurance provides life insurance protection for a specified period. The face amount of a policy is payable to a beneficiary if the insured dies during the term period, and nothing is paid if the insured survives. The period may be as short as one year, or it may run to age 65 and beyond. The customary terms are 1, 5, 10, 15, 20 and 30 years.

Such policies may insure for the agreed term only, or they may give the insured the option of renewing the protection for successive terms without evidence of insurability. *Evidence of insurability* is the basic purpose of underwriting, or evaluating the insurance risk by the insurer. When underwriting a proposed insured, the insurer asks for documentation and

evidence of  
insurability

other information regarding the physical condition and other attributes of the insurance applicant. This information is then evaluated to determine the acceptability of the applicant and to what rating class he or she will be assigned. Applications for term insurance are carefully underwritten; various restrictions may be imposed on the amount of insurance, the age before which it must be obtained, the age beyond which it cannot be renewed, and all insurability issues.

Term insurance is generally regarded as temporary insurance and is more comparable to property and casualty insurance contracts than to cash value life insurance contracts. If a person insures his or her life under a 5-year term contract, no obligation is incurred by the insurance company, unless the death of the insured occurs within the term. The typical pattern of premiums is for the rate to increase for each \$1,000 of insurance at each renewal. All premiums paid for the term protection are fully earned by the company by the end of the term, whether or not a loss has occurred, and the policy has no further value. This is similar to auto and homeowners insurance.

**adverse selection**

The premium for term insurance is initially relatively low, despite the fact that it contains a relatively high expense loading and an allowance for adverse selection. *Adverse selection* is the general tendency in insurance for selection against the company; that is, for the law of large numbers to be inoperative, because those who know they are vulnerable to specific risks are most likely to acquire and retain insurance to cover related losses. Adverse selection produces poorer loss experience among those who are insured than those who are not insured. The insurer must make every effort to prevent adverse selection in its underwriting and pricing by selecting a large, safely diversified, profitable group of applicants. However, adverse selection also occurs in term insurance when premiums increase as members age, prompting healthy members to withdraw from the plan and seek better rates, thus producing an abnormal increase in mortality rates for those less healthy and less insurable members who remain in the group. Term premiums must account for this tendency in its initial and renewal pricing as insured groups age.

The reason premiums can be low is that most term contracts do not cover the period of old age when death is most likely to occur and when the cost of insurance is high. In other words, a term policy, because its term may end prior to the insured's death, insures against a contingency, and not a certainty, as permanent insurance policies do. Term is priced to expire before the majority of insured individuals, so a death may or may not happen. If permanent remains in force, it certainly will pay the death claim eventually.

When insurance companies put term insurance in force, they must estimate expenses and the number of people who are going to die (mortality). Actual results will inevitably differ from these estimates. An insurance company can price aggressively by paring down estimates, calculating as

closely as possible, and charging as little as possible for mortality and expenses. To protect themselves, the insurer will specify in the contract that they reserve the right to raise rates in the future if they have premiums that are less than the mortality and expense costs actually incurred. Conservative estimates used to be the norm, but today the norm is to charge aggressively and reserve the right to increase rates in the future, if necessary. You will see this in illustrations and policies by the difference between current rates and maximum guaranteed rates that may be charged, and in how long current rates are guaranteed.

### ***Limiting Renewability***

If the surviving members of the insured group should continue to renew their insurance year after year, the steadily increasing premiums would cause many to question continuing the insurance. After a point, there would be a tendency for the healthy individuals to give up their protection, while those in poor health would continue to renew their policies, regardless of cost. This is an example of the adverse selection problem as discussed above.

The withdrawal of the healthy members would accelerate the increase in the death rate among the continuing members and, unless ample margins were provided in the insurance company's premium rates, could produce death claims in excess of premium income. In this event, the loss would be sustained by the company, because the rates are guaranteed for the entire period of renewability. For this reason, companies offering term insurance on an individual basis place a limit on the renewal period.

Even without restrictions on the renewal period, term insurance is not usually feasible for long-term protection. Increasing premiums cause many policyowners to discontinue their insurance at a time when, due to physical condition or other circumstances, they cannot obtain other insurance easily or cheaply. They are likely to resent that after years of premium payments at increasing rates, the insurance protection is lost, with no tangible benefits for the sacrifice involved.

More important is the fact that few, if any, individuals are able and willing to continue their insurance to advanced ages when death is most likely to occur. Yet the great majority of individuals need insurance that can be continued until death, at whatever age it might occur. This need led to the development of level premium insurance. Yet, the renewal premium may increase substantially at the end of the level term period, leaving the policyowner with the difficult option of renewing at a high premium, or dropping the coverage when it may still be needed.

Many term insurance contracts contain an option to renew for a limited number of additional periods, usually of the same length. The simplest policy of this type is the yearly renewable term (YRT) policy, which is a one-year term contract renewable for successive periods of one year each.

Longer-term contracts, such as 5- and 10-year term, are also usually renewable.

**Renewal Privilege.** The following is a typical renewal privilege as it might appear in an insurance contract:

The insured may renew this policy for further periods of 10 years each without medical examination, provided there has been no lapse in the payment of premiums, by written notice to the company at its home office before the expiration of any period of the insurance hereunder and by the payment in each year, on the dates above specified, of the premium for the age attained by the insured at the beginning of any such renewal period in accordance with the table of rates contained herein.

#### renewability

The key to *renewability* is the right to renew the contract without a medical examination or other *evidence of insurability*. This means the policyowner can renew the policy without submitting to a medical examination or providing other evidence of good health, simply by paying the renewal premium. Where the term policy contains no renewal privilege, or where it can be renewed only upon evidence of insurability satisfactory to the company, the insured may find that coverage cannot be continued as long as needed. Because of poor health, a hazardous occupation, a dangerous hobby, or some other reason, the insured might be unable to renew the contract or to obtain any other form of life insurance protection. The renewal feature prevents this situation. Its chief function is to protect the insurability of the insured.

Under a term insurance contract, the premium increases with each renewal, based on the attained age of the insured at the time of the renewal. The term insurance premium for a person aged 50 or above, for example, may be higher than the premium for a WL contract acquired before age 35. Within the contract period, however, the premium is level. Over a long period, punctuated by several renewals, the premium will consist of a series of level premiums, each series higher than the previous one. The rate will continue to increase with each renewal. The scale of renewal rates is published in the original contract and cannot be changed by the company as long as the contract remains in force. Companies protect themselves by having a guaranteed renewal rate, as well as the scheduled current renewal rate. The guaranteed renewal rate is higher than the scheduled rate in case experience goes against the company and the future develops differently than anticipated.

### Renewability Features

- Can renew without medical evaluation or other review
- Premiums change upon renewal
- Some insurers prohibit renewals beyond a specified age

Insurers have mixed feelings about renewable term insurance. There is no question that if properly used, it fills a real need. However, it presents certain problems for the company that writes it. Whether the policy is a YRT or a longer-term contract, there is likely to be strong selection against the company at time of renewal, and this adverse selection will become greater as the age of the insured, and hence, the renewal premium, increases.

### *Convertibility*

#### convertibility

In addition to the renewable privilege, a term policy may contain a *convertibility* provision that permits the policyowner to exchange the term contract for a permanent insurance plan, without evidence of insurability. A term insurance policy may be both renewable and convertible. These features add to the cost of the policy.

The convertible feature serves the needs of those who want permanent insurance, but are temporarily unable to afford the higher premiums required for WL and other types of cash value life insurance. Convertibility is also useful when the policyowner desires to postpone the final decision as to the type of permanent insurance to be purchased until a later date when, for whatever reason, it may be possible to make a wiser choice. Thus, convertible term insurance provides a way to obtain temporary insurance and an option on permanent insurance in the same policy.

Insurability is protected by the convertible feature in an even more valuable manner than under the renewable feature, because convertibility guarantees access to permanent insurance—not just continuation of temporary protection. The two features together afford complete protection against loss of insurability.

#### attained age

The conversion option may be effective as of the date of the exchange or as of the original date of the term policy. If the term policy is converted as of the current date, it is usually referred to as the *attained age* method since the current age determines the premium level. A conversion using the original date of the term policy for the conversion is referred to as the *original age* method or a *retroactive conversion*.

#### retroactive conversion (original age)

***Retroactive Conversion.*** Some insurers allow a policy to be converted retroactively within the first few years after issue. When the conversion is effective as of the original date, the premium rate for the permanent contract is that which would have been paid had the new contract been taken out

originally, and the policy form is that which would have been issued originally. These two features motivate the insured to convert retroactively in most instances. The advantage of the lower premium is obvious, but in many cases, the contract being issued at the original date contains actuarial assumptions or other features more favorable than those being incorporated in current policies.

Offsetting these advantages, however, is the fact that a financial adjustment—involving a payment by the insured to the company—is required, which may be quite substantial if the term policy has been in force for several years. This adjustment may be computed in a variety of ways. Most companies specify that the payment will be the larger of

1. the difference in the reserves under the policies being exchanged (some companies specify the cash surrender value), or
2. the difference between the premiums paid on the term policy and those that would have been paid on the permanent plan, with interest on the difference at a stipulated rate.

Under the second type of premium adjustment, an allowance is frequently made for any dividends that would have been payable under the permanent policy. Some companies require a payment equal to the difference in reserves, plus a charge of up to 8 percent to provide the previously forgone investment return.

The purpose of the financial adjustment is to place the insurance company in the same financial position it would have been had the permanent contract been issued in the first place. Apart from the possibility of obtaining more favorable actuarial assumptions, there does not seem to be any financial advantage for the insured to convert retroactively.

The insured will pay a smaller premium, but by making up the deficiency in the term premium, will pay it over a longer period; actuarially, the two sets of premiums are equivalent. The fact is that the insured pays the company the interest it would have earned had the larger premium been paid from the beginning.

The insured should consider many factors in making a choice between the two types of conversion, one of the most important being the state of his or her health. The insured would be ill advised to convert retroactively—and pay a substantial sum of money to the insurance company—if he or she is in poor health. The sum the insured will have to pay will immediately become a part of the reserve under the contract and will not increase the amount of death benefits in the event of the insured's death. The payment will simply reduce the effective amount of insurance.

In most cases, if the insured has surplus funds to invest in insurance, he or she should consider purchasing additional insurance or perhaps prepaying premiums on existing policies, including a newly converted one. Subject to

certain limitations, most companies permit the insured to prepay fixed premiums, either in the form of premium deposits or through discounting of future premiums. The two procedures are very similar. The principal difference is that under the discount method, credit is taken in advance for the interest to be earned on the funds deposited. Under both arrangements, the funds deposited with the company are credited with interest at a stipulated rate, and in some instances are credited with the interest earned by the company in excess of the stipulated rate. In the event of the insured's death, the balance of any such deposits is returned to the insured's estate or beneficiaries in addition to the death benefit of the policy. Some companies permit withdrawal of premium deposits at any time, in which case a lower rate of interest may be credited, while others limit withdrawals to anniversary or premium due dates. A few companies permit withdrawals only in case of surrender or death, and some companies credit no interest or penalize the insured if the funds are withdrawn.

***Time Limit for Conversion.*** A retroactive conversion must take place within a specified number of years after issue. If the term of the policy is no longer than 10 years, a conversion as of a current date can usually be accomplished throughout the full term. If the term is longer than 10 years, the policy may stipulate that the conversion privilege must be exercised before the expiration of a period shorter than the term of the policy. For example, a 15-year term policy must usually be converted within 12 years from date of issue, a 20-year term policy within 15 years.

The purpose of a time limit is to minimize adverse selection. There is always a substantial degree of adverse selection in the conversion process. As the time limit for conversion approaches, those policyholders in poor health are more likely to convert and pay the higher premiums than those who believe themselves to be in good health. If the decision to convert must be made some years before the expiration of the term policy, a higher percentage of healthy policyowners, uncertain of their health some years hence, will elect to convert. Experience has shown that the death rate among those who convert is higher than normal. This accounts for the fact that premium rates for convertible term insurance are somewhat higher than for those without the conversion privilege. Because policies with renewable and convertible features extend the risk to the insurer, the premiums are higher than policies without those features, or with those features that terminate earlier.

If the policy is renewable, the only time limitation may be that it is converted before age 60 or 65. In other cases, the contract will state that the policy must be converted within a certain period before the expiration of the last renewal period. In all cases, conversion may be permitted beyond the time limit, but within the policy term, upon evidence of insurability.

Some companies issue term policies that are automatically converted at the expiration of the term to a specified plan of permanent insurance. It is doubtful that this procedure is effective in reducing adverse selection, since healthy individuals may fail to continue the permanent insurance.

### ***Guarding Against Contestability***

In general, it is a good idea to keep existing coverage in force until after the intended replacement coverage has actually been issued and the policy delivered. It is important for the policyowner to realize that new policies remain contestable for at least one or two years. If the insured dies while the policy remains contestable, the claim will be investigated much more thoroughly and take longer to settle than one for a policy that is already incontestable.

### **Types of Term Insurance**

There are a number of different types of term insurance. We will now review the major types.

#### ***One-Year Term***

YRT is the most efficient way to provide for life insurance needs when maximum protection is desired with the current minimum outlay of cash. This product was discussed in Chapter 1 as an example of how term insurance works. Sales of YTR in 2005 represented about 5 percent of new term policies sold. Because of its simplicity, advisors view this product as the easiest life insurance product to sell, by far.

#### ***Re-entry Term***

**re-entry term**

**select mortality**

**ultimate mortality**

The life insurance industry has developed a term insurance policy intended to charge higher premiums to those in poorer health when they renew their term insurance, thereby reducing the degree of adverse selection. The product is commonly called *re-entry term insurance*. It is a policy subject to two different premium schedules. The lower premium rate is based on *select mortality* (applicable to an insured who has recently given evidence of insurability, indicating that he or she is in good health and meets other insurable criteria). The select rates are available as long as the insured is able to provide new evidence of insurability at each renewal date and at other dates specified by the insurer.

The higher premium schedule is based on *ultimate mortality* rates (applicable to insureds at least 15 or 20 years after they last provided evidence of insurability). The insureds that cannot provide evidence of

insurability acceptable to the insurance company when requested or required must pay the higher premium schedule rates to renew their coverage. They are known to be in poorer health and have to pay for the increased risk now and probably with each subsequent renewal, unless they experience an improvement in health.

It is hard to argue with the logic or fairness in this approach. The reentry approach transfers some of the risk traditionally borne by the insurer to the policyowners. In order to get the lower premiums while healthy, the individual should be willing to pay the higher premium when his or her health deteriorates. However, it is questionable whether the policyowner knows or realizes the full import of a decision to buy re-entry term insurance. Young people in good health believe they are immortal and will never have to pay the higher rates. Few of them stop to consider that they may actually end up paying the ultimate rates and that when that happens they may not be able to buy coverage from another insurer. The single premium schedule term insurance they could have bought instead of re-entry term might have been a significant bargain. Unfortunately, when that realization sinks in, it is too late to select that option.

Re-entry term is economical for those who remain healthy into their retirement years, but it may end up being very costly for anyone whose health deteriorates at about the same rate as that of the general population. On average, people start to experience declining health between the ages of 45 and 55. If they reach their life expectancy (at least 50 percent should), they can live 40 to 50 years in an impaired physical condition—paying the higher term rates for many more years than they enjoyed lower term rates.

---

**Example:** Mary purchased a re-entry term policy 3 years ago. She saved 10 percent based on the premiums that would have been required for a traditional renewable term policy that guarantees future premium rates. Mary suffered a severe heart attack just before she was required to have her health reassessed for the re-entry term. Her new premium is more than double what the renewal premium would have been under the traditional renewable term policy. That difference may get even larger in the future.

---

The decision to purchase re-entry term insurance should involve comparison of the high renewal rates of competing insurers for similar coverage. If the insured cannot provide satisfactory evidence of insurability, the lower premium schedule is irrelevant. Helpful in making such

comparisons are projected premiums (both high and low rates) for each policy being considered at a range of premium increase dates. Another important point for evaluation is whether the insurer considers the policy a new contract with a new contestable period after the insured fails a re-entry test. Some insurers treat the new premium as an adjustment on continuing coverage, but others impose a new contestable period.

An approach known as indeterminate premium term provides for maximum guaranteed premiums chargeable during the life of the contract. The initial premiums reflect the select rates available through recent underwriting, as well as competitive pricing pressure. The initial low premium is guaranteed for the first renewal period, depending on the contract's duration, with subsequent premiums dependent on the insurer's future mortality, investment, and expense experience. In no case will the subsequent premiums exceed the guaranteed maximums in the contract, so the guaranteed premiums are considerably higher than the current rates projected.

### ***Long-Term Level Term***

#### **level term**

While term contracts initially provided protection for a relatively short period, subject to renewal for successive periods of the same duration, most term contracts today are designed to provide long-period protection. *Level term* is used to describe both a premium and face amount that remain the same during the policy period. These policies often give prospects the option to purchase waiver-of-premium and accidental death benefits, as well as other policy benefits.

Today, you can find many companies offering 5-, 10-, 15-, 20-, and 30-year terms. Term policies with 10- and 20-year level premium periods represented 65 percent of term sales in 2005. In addition, 15- and 30-year level premium plans have also grown in popularity over the last few years (25 percent of new sales combined), due to increased sales of ROP plans. These designs attempt to avoid the objection people have to the annual increase in the cost of term insurance. The insurance company adds up the number of annual premiums that will be required on the policy in total, divides by the number of years for which the level premium is guaranteed, discounts for the time value of the money using assumed interest rates, and charges the resulting level premiums, rather than the actual YRT rate. This process is similar to the process used for all level premium plans. The insurance company charges more in the beginning, so they will not have to charge a higher amount as time goes on. This is also riskier for insurers, since aggressive pricing and underwriting are common in a very competitive environment, and reserves and margins may not be sufficient years down the line on the longer guaranteed periods. To offset the increasing adverse

selection in longer-term contracts, the policy may change to an annually renewable premium schedule after a certain age or time period.

A term-to-65 contract, for example, provides a level premium from the age of issue to age 65. It is not to be confused with YRT or other forms of term insurance that can be renewed until the insured reaches age 65. The period covered by this contract is normally shorter than the life expectancy, but its termination date coincides with the age generally regarded as the normal retirement age. Because the term is shorter than that of WL contracts, the premium will be smaller. A conversion privilege may be offered, requiring conversion prior to age 60 or within the first 10 policy years.

### ***Nonlevel Term Insurance***

The preceding discussion focused on term insurance for which the amount of insurance is level throughout the term of the policy. This is not necessarily the case, since the amount of insurance may increase or decrease throughout the term.

#### **decreasing term insurance**

***Decreasing Term.*** A substantial portion of term insurance provides systematic decreases in the amount of insurance from year to year. This type of term insurance, called *decreasing term insurance*, may be written in the form of a separate contract, a rider to a new or existing contract, or as an integral part of a combination contract. Mortgage redemption insurance is the most familiar form of decreasing term insurance. The premium remains constant as the death benefit declines as the insured ages. This type of insurance is useful when the insurance need at the insured's death diminishes over time. In addition to a decreasing loan balance, the need to provide funds for dependent children decreases as they grow. Each year a parent survives and provides a dependent's support is one less year needed should the parent die before the child reaches maturity.

If the decrease in the term insurance is offset by an increase in an investment fund, the total amount of cash available at death remains constant. This is one line of reasoning in the "buy-term-and-invest-the-difference" argument, which we will discuss later.

#### **payor benefit**

The *payor benefit*, available as a rider to a policy insuring a juvenile, is another example of a decreasing term rider. This rider provides a death benefit and waiver-of-premium benefit on the life of the premium payor, usually a parent. The decreasing death benefit on the payor's life is sufficient to pay all the premiums that would be due on the juvenile's policy from the payor's death to the insured's age 21. The benefit is designed to ensure that the premium due on the juvenile's life insurance policy will be paid if the premium payor dies.

#### Renewable Term Characteristics

- Coverage for a stated period
- Premium based on age at beginning of each new period
- Premiums increase with age
- Rate of premium increases accelerates after age 40
- Can be renewed for a new period without health assessment (up to limiting age specified in policy)
- Additional charges for adverse selection included in premium at advanced ages
- Does not provide living benefits such as cash values, policy loans, and so on

#### increasing term

**Increasing Term.** *Increasing term* provides insurance for which the face amount increases monthly or yearly while the premium remains level. It can be written as both a separate policy and as a rider, but is mainly found in combination with cash value policies under special plans, such as cost-of-living protection, return-of-cash value and ROP riders.

The cost-of-living adjustment (COLA) rider to a cash value policy allows for automatic face-amount increases each year in conjunction with the rate of inflation, as measured by an index such as the Consumer Price Index (CPI). The policyowner is billed for the increases with the regular premium notice. No evidence of insurability is required for these increases as long as the rider remains in force and is exercised each year. This requirement minimizes the possibility of adverse selection.

Another type of increasing term insurance is provided by the ROP feature or rider. This feature provides that, if the insured dies within a set number of years from the policy issue date, the death benefit will be increased by an amount equal to all or a portion of the premiums paid to that point. The increasing term benefit is set to equal the sum of premiums paid up to that year. This feature makes the term insurance more attractive to prospects who may not like the fact that no benefit is paid if the insured survives to the end of the term period.

#### one-year term option

The same concept is used in the “fifth-dividend” or *one-year term option* in participating policies. Some amount of dividend can be applied each year in an amount equal to the year-end cash value. Applying this option can insure the cash value, so that in the case of the death of the insured, the cash value would be paid in addition to the death benefit. In this way the cash value can be added to the death benefit.

#### **Return-of-Premium Term**

ROP term products have become more popular over the last 4 or 5 years. They tend to be middle-market focused and target individuals concerned with protecting mortgage payments, as well as income and savings. ROP policies tend to have smaller average face amounts than non-ROP policies. Return of

premium is offered as a rider attached to a level premium term policy, or as part of the base plan. Fifteen, twenty and thirty-year level premium periods are the most common ROP offerings. Producers report that they consider ROP term a more difficult sale than either UL or WL. This may be because it is a relatively new concept for most advisors and they are not yet comfortable with the basic product design and sales process.

The advantage of term life insurance is affordability. The downside is that it is a pure risk policy, and if you outlive the policy, it has no further value and your money is spent. Nothing is paid to either the policyowner or the beneficiary. The perception is that the premium has been “thrown away,” since nothing is returned and no claim payment is made. (This is, of course, an inaccurate perception, since the insurance protection was provided during the term of coverage. Nevertheless, many individuals see it this way.)

**return-of-premium  
term**

Under *return-of-premium term*, if you live to the end of the policy period, your premiums are returned, and a few companies offer a partial return of premium if the policy is terminated. If the policy is surrendered, there may be no refund, and there may be a surrender charge in the early years. The longer premium payments are made, the higher the percentage of return. Some argue that ROP life insurance is an excellent combination of the best features of both term and WL.

The insurance company benefits from the extra premium it charges, which is approximately 1.5 to 4 times the premium for non-ROP term. This extra premium will earn an investment return—enough to provide the money for insurance companies to return premiums, cover their expenses, and earn a profit. The policyowner does not get the investment return on the extra premium paid over a traditional term policy. That money is kept by the insurance company, which is how they offer this product, taking their expenses from the investment component. It is not “free” insurance, but to many it feels like it is. People do not like to spend money on something they don’t think they will use. Statistics vary, but approximately 95 percent of all term policies sold do not result in a death claim. Lapse rates are expected to fall since the policyowner benefits by increased premiums returned the longer the policy remains in force. This also helps reduce the mortality adverse selection.

The main determinant of the extra charge for the ROP feature is the length of the coverage period. The longer the period of coverage, the lower the cost of the policy, because there is more time for the additional funds to grow. This approach makes good financial sense with a 20- or 30-year term, but it is less attractive if the term is less than 20 years. Shorter periods will be considerably higher, since there is less time for the insurer to pay back the premiums plus cover its costs and provide a profit. If the policy is surrendered or lapsed in the early years, there may be no refund at all and surrender charges may apply. Holders of term insurance keep their policies an average of only or 9 years before they drop the coverage or switch

policies. Over a 20- or 30-year period, a policyowner may drop the more expensive ROP policy and consequently pay more than a regular term product.

Premiums paid that are returned are not taxable, because they are a return of premium. The return of premium is such a popular concept with consumers that it is now included in other products, such as UL.

### ***Combination Plans***

Combining different types of coverages is nothing new, and appears to be gaining popularity in new product development. Insurers are always seeking ways to package benefits that will appeal to a larger market segment or help overcome objections to buying certain coverages.

At least one insurer has recently introduced a ROP term product with coverage for major medical, disability, doctors' visits, routine dental care, and prescription drugs. Policyowners can control their exposures and costs by selecting the plan benefits and premiums that best suit their needs and budget. This concept has been used to link together long-term care and other benefits in permanent insurance policies. This trend is expanding.

### ***Riders Available on Term Insurance Policies***

There is a wide variety of riders available on term policies, many may be available on policies you sell. Below is a listing of common riders found with term insurance. Some of them may be similar, but reflect the possible names for riders found throughout the industry.

- Waiver-of-premium rider
- Children's level term rider
- Spouse and children's rider
- Accidental death-benefit rider
- Accidental death and dismemberment rider
- Accelerated death-benefit rider
- Additional insured rider
- Other covered insured rider
- ROP rider
- Guaranteed premium rider
- Five-year term rider
- Increasing-premium term rider
- Policy purchase option rider
- Spouse's paid-up insurance purchase option rider
- Guaranteed insurability rider
- Living benefits rider

- Unemployment waiver-of-premium rider
- Long-term care rider
- Long-term care with terminal benefits rider
- Long-term care with terminal benefits and extension-of-benefits rider
- Critical illness rider
- Disability income rider (accident only or accident and sickness)
- Family income rider
- Cost of living rider
- Level-term-to-65 rider

As you can see there are many and this list is not exhaustive.

### **Uses and Limitations of Term Insurance**

Term insurance has long been the subject of debate. Many people, not familiar with or perhaps not sympathetic to the principle of level premium insurance, advocate the use of term insurance in all situations, to the exclusion of permanent insurance. There are certain insurance “consultants” who, when they find permanent plans in an insurance program, will advise their surrender for cash and replacement with term insurance. It will be helpful to point out the areas that can legitimately be served by term insurance and to analyze briefly some of the arguments that have been advanced in favor of term insurance.

#### ***Uses of term insurance***

Term insurance is suitable when

1. the need for protection is purely temporary;
2. the need for protection is permanent, but the insured temporarily cannot afford the premiums for permanent insurance;
3. it is used as a supplement to permanent life insurance.

#### ***Temporary Need for Protection***

In the first case, term insurance is the complete answer, but it should be renewable in the event that the temporary need should extend over a longer period than was originally anticipated. The policy need not be convertible, but since relatively few people carry an adequate amount of permanent insurance, and since the loss of insurability is a constant threat, it is advisable to obtain a policy with a conversion privilege.

Examples of temporary needs that can, and should, be met through term insurance are encountered daily. It is best suited for situations in which the

protection need will expire simultaneously with the term expiration date. One of the most obvious is the need to hedge a loan. A term policy for the loan amount, payable to the lender, not only protects the lender against possible loss of principal, but also relieves the insured's estate of the burden of repaying the loan if the insured dies. Lenders frequently request, and sometimes require, that borrowers purchase life insurance as a condition for the loan. A mortgage redemption policy serves the same purpose. An individual who has invested heavily in a speculative business venture should protect his or her estate and family by obtaining term insurance in the amount of the investment.

If a business firm is spending a considerable sum in an experimental project, the success of which depends on the talents and abilities of one individual or a few individuals, term insurance on the appropriate person or persons will protect the investment. A parent with young children is likely to need more insurance while the children are dependent than he or she will need when they have grown up and become self-sufficient. The additional insurance during the child-raising period can be—and usually is—provided through term insurance. Frequently, decreasing term insurance is superimposed on a plan of permanent insurance. Parents who depend on their current earnings to finance their children's college education find term insurance to be a useful means through which to provide the necessary college education fund in the event of the death of the breadwinners.

In each of the forgoing examples, a financial loss occurs only if the insured dies before a specified date. These examples are just a few of the many situations in which term insurance is especially useful. However, the use of term insurance is not limited to providing protection to individuals whose needs are for a specified period. If budget constraints prohibit purchasing the desired amount of permanent insurance, term insurance is often substituted.

---

**Example:** Tom and Marsha have two very young children and need more life insurance to protect them. However, Marsha will become the recipient of a large trust in 8 years. At that time, they will have a diminished need for life insurance. Term insurance is appropriate for the temporary need.

---

A concept that may be useful in selling term insurance is known as laddering. Just as one may ladder bonds or certificates of deposit, an individual can purchase several term policies of varying durations to meet specific needs. For example, a parent may buy a 10-year level-premium term policy to ensure money is available for the children's college costs; a 20-year

policy to pay off what remains of the mortgage; and a 30-year policy for income replacement for the spouse. These three policies cost far less than a single 30-year policy covering all the risks. It also helps the policyowner remember the purpose of the policy and the need that it addresses. By looking out for the client's best interest, the client may come to view the advisor as trustworthy, which could lead to further sales and referrals. This term concept is a way for advisors to grow their business and develop long-term relationships with clients.

### ***Lack of Finances for Permanent Insurance***

Term insurance is useful for people with low incomes and high insurance needs. Good risk management principles suggest that a family should be protected against catastrophic losses. If current family income cannot afford permanent insurance in adequate amounts, the prospect has no choice but to buy term if adequate financial protection is to be provided.

Term insurance can be useful for those who have placed essentially all of their resources in a new business. Death of the business owner could result in loss of the invested capital. It also means all resources have been committed and there are none for surviving family members. Term insurance can serve as a hedge, especially in the vulnerable early stages of the business. Additionally, term will have a low premium requirement, as it is newly underwritten and has select rates.

Term insurance is particularly important to young people who expect substantial improvement in their financial situation as the years go by. Young professionals who have made a considerable investment in their education and training, but whose practices must be built up gradually, are likely prospects for term insurance. They may have student loans that need to be repaid. If they should die before the loans are repaid, that obligation could fall on their estate. Young business executives are also good prospects. Term insurance provides a high level of protection at a low premium. In these circumstances, term is used not because the need is temporary, but because the financial condition is temporary. Convertible term is especially useful in these situations, because it assures the later availability of permanent insurance.

This second use of term insurance requires that the policy be convertible. The conversion privilege is the bridge that spans the gap between the need for permanent insurance and the financial ability to meet the need. In this case, since the insured's financial situation might persist longer than anticipated, the policy should be renewable, as well as convertible. The renewable and convertible features serve different functions, and ideally should be incorporated in all term policies.

### *A Supplement to Permanent Life Insurance*

In other situations, the life insurance need is not temporary but is still met with term insurance. Many established people need more death benefit than is affordable on a permanent basis. These persons may decide to sacrifice living benefits (cash values) in order to provide their families with adequate premature death protection.

An excellent use of term insurance is as a rider to a permanent insurance plan. The combination provides the desired amount of insurance protection within a budget, provides some permanent protection with cash accumulation, and allows for conversion of the term rider if desired in the future. This may be especially useful in the child-rearing period of a young family, or when children go to college or pursue other post-secondary education. Level, increasing, or decreasing term riders are often packaged with permanent forms of insurance to create a combination of death benefits and living benefits that fit a person's particular needs and resources. For example, an individual requires \$200,000 in life insurance coverage, but can not afford the premium for a permanent plan of this amount. An affordable option may be to purchase a \$50,000 permanent policy with a \$150,000 term rider. That mixture would provide the desired amount of insurance with limited cash value accumulation, at a premium that fits within a given budget.

### *Limitations of Term Insurance*

Every policy has advantages and limitations, and term is no different. There are disadvantages to using term when there is a need for permanent life insurance:

1. You have to die to "win." Although term insurance provides needed and valuable protection, when the term coverage ends, so does the protection. If you stop paying premiums, the coverage ends. No policy values are recovered, unless death of the insured occurs during the term period. Term is often compared to renting a house. As long as you pay the rent, you get full use of the house, but as soon as the lease expires, you must leave and you have no equity or value that belongs to you.

Suppose an insured is covered with \$500,000 of term insurance. The coverage has been in force for 10 years, and the policy expires at midnight on December 31. If he dies at 11:59 on New Year's Eve, his family receives the full \$500,000 in death-benefit proceeds. However, if he dies at 12:01 on January 1, the family receives nothing under the policy, since the contract has expired.

2. The need for life insurance may extend beyond the policy period. The insured may become uninsurable and be unable to renew or obtain a new policy. Not all policies have renewal or conversion rights, and even when they do, they expire after a certain age or a certain number of years of coverage.

The premium increase at renewal may be beyond the policyowner's ability to pay. Premiums increase until they become prohibitive at later ages. A person may buy term coverage in his or her 20s because it seems more affordable than cash value insurance with the same death benefit. By the time they're in their 40s, the coverage seems a bit pricey, as the rate goes up. In their 50s, the cost has generally outstripped the cost of permanent insurance. Finally, in their 60s, if not sooner, they drop the coverage, not because they no longer need the protection, but because they cannot afford it, or do not want to spend that amount of money on it.

3. Term has no tax-free automatic savings features. Many people benefit from the savings feature of cash value life insurance. Permanent insurance can serve as a vehicle for accumulating funds for emergencies, retirement, and other savings goals. Many people are unable to save for an extended period unless faced with some compulsion or penalty. Traditional cash value insurance addresses this problem. Even those who save regularly will be less likely to raid their cash value life insurance than other savings vehicles. The cash value growth within the life insurance policy is tax-deferred, giving it an advantage over currently taxable vehicles. Additionally the waiver-of-premium clause will allow the savings plan within permanent insurance to be "self-completing" if the insured become permanently disabled.
4. Although the premiums are initially lower, term insurance may be more expensive than permanent insurance in the long run. Mortality assumptions used in calculating term premiums project higher death rates than those used in WL policies, because of the higher adverse selection associated with term policies. Despite the initial higher premiums under the level premium plan, permanent insurance can actually be less expensive over a lifetime.

### ***Danger of Relying Solely on Group Term Insurance***

Many employers offer life insurance as part of their benefits package for employees. It is an effective way to insure a worker, and often the worker's family members, at a cost that is generally lower than purchasing individual coverage. However, relying solely on group insurance may not be the best way to ensure that the family is provided for in the case of the death of the breadwinner.

In these times of fierce competition and corporate downsizing, it can be precarious to rely heavily on employer-provided group life insurance to satisfy all or most of a family's death-benefit needs. The main disadvantage of employee life insurance is that it is term insurance and the protection usually ends when the employee terminates employment. If a person leaves their current position for another, there is always the possibility that the new employer will not provide employee life insurance. This could leave the worker without life insurance protection.

Additionally, the group term may not be flexible and adaptable to individual needs. Group life insurance is geared toward meeting the general needs of the group being covered. In most cases, it cannot be customized to meet individual needs. Since there is no individual underwriting on group life, individually underwritten term may be cheaper, since the group term must account for the adverse selection resulting from liberalized underwriting. It is best to think of group term life as a supplement to a personally owned life insurance program.

Individuals should find out how much of the employer group coverage can be converted after an involuntary termination of employment, for example, mandatory early retirement, workforce reduction, plant closing, reorganization after a merger or acquisition, employer bankruptcy, statutory banning of a product (freon, for instance), or chronic health impairment resulting from accident or disease. Individual term insurance may be appropriate to cover the potential reduction in coverage after post-employment conversion of the existing coverage. The safest way for the individual to cover this risk is to purchase an individual policy while he or she is still employed. The cost of such risk avoidance is the amount spent on premiums for coverage in excess of the individual's current needs, between buying a policy and termination of employment.

### *Arguments in Favor of Term Insurance*

Some of the arguments in favor of term insurance can be described as criticisms of level premium insurance. Most of the arguments can be consolidated into two points of view:

1. Level premium insurance overcharges the policyowner.
2. The accumulation and protection elements should be separated.

The basis for the first claim is the fact that if a policyowner dies in the early years of the contract, premium outlay under the level premium plan is considerably larger than it would have been under a term plan. According to the term advocates, the policyowner paid a larger premium than was necessary. Term advocates question whether it is wise for the insured to pay

in advance for something he or she may never need or live to enjoy. They argue that it is better “to pay as you go and get what you pay for.”

There is no question that insureds are far better off financially with term insurance if they can be sure they will die within a relatively short time. On the other hand, they are far worse off if they guess wrong and live to a ripe old age. Although no one knows whether he or she will die young or live to an old age, the chances of living to an age where the total term premiums exceed the total premiums paid under a level premium plan are relatively high.

The level premium plan protects the insured against the consequences of living a long time and having to pay prohibitive premiums for insurance protection. It shifts a portion of the premium burden of those who live beyond their life expectancy to those who die young and produce an exceedingly large return on their premium outlay. Since no one can know at the outset which group he or she is in, payment of the level premium by all is a fair and satisfactory arrangement.

Those who argue that level premium insurance overcharges policyowners, sometimes assert that the reserve under permanent forms of insurance is forfeited to the company in the event of the insured’s death. To correct this “inequity,” they contend the normal death benefit should be increased by the amount of the reserve.

This argument strikes at the very heart of the level premium plan. As discussed in Chapter 1, the essence of the level premium plan is a gradual reduction in the net amount at risk as the reserve increases. If the reserve is to be paid in addition to the face amount of the policy, this reduction in the amount at risk does not occur, and premiums that were calculated on the assumption of a decreasing risk will be inadequate. Companies that offer a contract that promises to return the reserve in addition to the face amount of the policy have premiums that increase according to the additional risk amount.

The second claim—that the savings and protection elements of the contract should be separated—is based on the proposition that an individual can invest his or her surplus funds more wisely and with a greater return than the life insurance company can. Those who believe this recommend that individuals buy term insurance and then place the difference between the term premium and the premium they would have paid for level premium insurance in a separate investment program. This is known as a “buy-term-and-invest-the-difference” strategy. Some suggest investing this difference in premiums in government bonds, others recommend investment trusts or mutual funds, while others advise an investment program in common stocks. This argument needs to be analyzed in terms of the objectives of any investment program, and will be discussed in the next chapter.

### ***Term Product Selection***

The selection of a particular type of life insurance policy or product portfolio is largely a personal decision. Just as some people prefer to lease an automobile or rent an apartment, others prefer to own them. While some individuals may prefer to put down a large sum of money and pay off a loan or mortgage as quickly as possible, others want to make a minimum down payment and stretch payments out for as long as possible. For many clients, there is an emotional comfort in ownership, while for others, ownership ties them down and restricts their freedom of choice and flexibility. Similar comparisons can be made to life insurance policies. Some clients do not want to pay for years and have nothing to show for their investment, while others may have been told for years to buy term and invest the difference. There is really no right answer, unless we know when the insured will die. For most clients, the right course of action usually lies in choosing the option with which they are most comfortable, since peace of mind is one of the most important reasons for purchasing a life insurance plan.

When comparing term policies, consider the following:

- In the case of renewable term, check the schedule of future renewal premiums. A policy with the lowest initial premiums may have higher renewal premiums than other policies. A policy that is priced aggressively may not be able to sustain those premiums when renewal time comes.
- Check the age to which coverage may be continued without evidence of insurability. A policy with a lower premium may discontinue the automatic right to renewal before other higher priced policies.
- Check the age to which a convertible policy may be converted without providing evidence of insurability. It may be worth paying additional premium to guarantee this right for additional years. Check if the conversion clause allows the client to convert the term to permanent with a waiver-of-premium provision without evidence of insurability. Some companies allow conversion when the policy is disabled and on a waiver-of-premium benefit, so that the converted policy is now on waiver (at a higher premium). Some companies do not allow a waiver-of-premium rider on the converted policy, unless the insured shows evidence of insurability. Some companies will allow the converted policy to have a waiver-of-premium rider without evidence of insurability, but will restrict the waiver benefit to disabilities that occur after the date of conversion.
- Check the periods of coverage with respect to waiver-of-premium and other riders, and the provisions of those policy features that are important to the client. Many small differences in policy terms and clauses can make big differences in benefits and premiums. In

general, it is worth paying a higher premium to have a policy that has more liberal rules regarding policy benefits.

---

## MARKETING, PROSPECTING, AND APPROACH

---

### Marketing

marketing

*Marketing* is the planning and implementation of a process dedicated to identifying specific consumer needs, isolating groups of people who have those needs, and then producing and customizing the products and services that satisfy those needs. It is the art of planning when, where, why, how, and to whom to sell. Successful marketing focuses on the needs of the consumer and produces a mutually beneficial relationship between a buyer and seller.

### *Marketing versus Selling*

selling

Because marketing involves planning, much of marketing does not involve interaction with a buyer for the purpose of making a sale. Many believe that marketing and selling are the same, but in reality, selling is a part of marketing. *Selling* is the end result of successful marketing. It is the transaction resulting from the encounter between buyer and seller, the exchange of the product or service for the buyer's cash.

### *Objectives of a Marketing Strategy*

The goal of the selling/planning process is to win clients. Any effective marketing strategy you create should accomplish four goals:

1. Create a perpetual qualified prospect machine.
2. Decrease your appointments to sales ratio (increase efficiency in winning clients).
3. Decrease your contacts-made-to-appointments ratio (decrease the amount of time and energy devoted to prospecting).
4. Focus and specialize to create a higher value for your services.

***Perpetual Qualified Prospect Machine.*** A perpetual prospect machine provides you with a continuous flow of new prospects and requires little intervention, and no cold calls. The best way to create such a machine is through referred leads. For example, if each good client gives you two referrals that turn into sales with other good clients, your business would grow exponentially. One client could result in multiple good clients through referrals, and each of them could result in multiple referrals, creating a

perpetual stream of prospects in a manner requiring little time and resulting in more sales for your efforts. People tend to associate with others who share similar values, characteristics, and needs, so there is a good chance that the referrals will be good clients.

**Lower Appointments-to-Sales Ratio.** Your plan or strategy should help you decrease the number of appointments it takes to generate a sale. The fewer appointments it takes to generate a sale, the better you are doing in your sales interview, prospecting, and marketing. If your strategy does not improve your ability to convert prospects into clients, you need to revise it.

**Lower Contacts–Made-to-Appointments Ratio.** You can also measure a strategy's effectiveness by whether or not it is reducing the number of contacts needed to set up an appointment. A good strategy will allow you to spend less time prospecting and more time helping your clients.

**Focus and Specialization.** If you had to have heart surgery, who would you like to perform the surgery, a heart surgeon or a general surgeon? Naturally, you would want the specialized heart surgeon. In the same way, a prospect will feel more comfortable with your services if they know you have worked with others *like them*, namely their peers and friends.

A good marketing strategy will help you focus on a market or a few related markets for which you can become the insurance or financial services expert. By establishing a marketing focus, you will be able to create a reputation that will precede you and greatly enhance your referability. You will want to make sure the market you focus on will be profitable. This will have a direct impact on your ability to see more qualified prospects, and thus, create more clients. It will not happen overnight and it certainly will not happen if you do not have a plan.

#### target marketing

Instead of pursuing opportunities and choosing a market in a random fashion, take a more systematic approach. This approach is called *target marketing*, in which you look for a group of people (a segment) which is large enough, so you will never run out of potential contacts, and small enough that the members are interrelated to the degree that your reputation will precede you. The group should be identifiable and accessible, with members who have common characteristics and needs, and communicate with one another.

Target marketing can occur inside or outside of your natural markets. A natural market is the group of people to whom you have a natural affinity or access because of similar values, lifestyles, experiences, attitudes, and so on. General markets are people in general, undifferentiated, meaning anyone and everyone is a prospect. Because of the advantages of selling in your natural markets, it makes sense to begin your target marketing efforts within

them. In this section, you will learn to target market within your natural markets by

- identifying groups with similar characteristics and needs (also known as market segmentation), and
- finding and targeting groups that meet the target market criteria.

### ***The Benefits of Target Marketing***

You will find that using the target marketing process will

- increase your efficiency within your natural market
- create a perpetual qualified prospect machine
- increase your visibility and prestige
- provide for systematic expansion of your natural market
- help you identify new opportunities

Using this process, you will be able to set appointments and sell more efficiently, which translates into either more time to see more people or more free time.

### ***Segmenting Your Market***

The first step of target marketing is to find possible target markets. Do this by dividing or segmenting your general and natural markets into small groups based on common characteristics. This simply means that you should organize your natural market into groups of potential prospects who have similar characteristics, needs, motivations, and buying behaviors. Segments can be identified and categorized by occupation, lifestyle, attitude, age, and so forth. They should be large enough to warrant your time, but small enough that they have some differentiated characteristics or needs. The process of discovering your target markets involves market segmentation.

### **Qualifying Prospects**

**qualified prospect**

The prospect selection process requires qualifying your prospects, moving them from being “suspects” to “prospects.” To do this you will have to establish the four characteristics of a *qualified prospect*. Qualified prospects display certain characteristics that make them potential customers for life insurance:

- They need protection from loss of life.
- They can afford to pay the premiums for the protection.

- They can be approached by you.
- They are insurable.

**Needs and Values.** It would be rare to find a person that had no need for your products or services. However, they may or may not value the service and products you provide. The key, as always, is to ask questions and listen. Explore whether or not there have been any major financial changes in the prospect's life over the past year. You might ask if they have purchased a new home, had a baby, had a death in the family, received a promotion or raise, or made any significant purchases. The answer to these questions and others will indicate if they have needs, and if so, how they want to meet them.

**The Ability to Buy.** Based on what you know or can observe personally, you may be able to assess whether a prospect can afford your products and services. You might not know the details until you get involved and start gathering information, but your initial observation should start you on the way. Despite someone's needs and values, remember to limit your contacts to people who can afford to pay the premium.

**Approachability.** It is not always easy to determine the approachability of a prospect. You may discover that people who might be good prospects are simply not approachable. This is why we have stressed the importance of identifying and working in and from your natural markets. It will increase your ability to establish rapport through common attitudes and interests, and perhaps similar lifestyles, incomes, or education. Most advisors work with prospects with whom they share common interests.

**Insurability.** You might not know whether a prospect is insurable until you begin working with them. Be sure you know your company's guidelines for standard issue. As you talk to people, keep these qualifications in mind. If you know about a prospect's poor health or other reasons they cannot meet underwriting requirements, you will need to make a business decision. While they may not be prospects for life insurance, they may be prospects for annuities, or they may be centers of influence or sources of referrals.

### **Motivating Prospects: What They Want and Do Not Want**

There are many reasons why prospects do not buy the life insurance they say they need. LIMRA International conducted a study of 68 couples, empty nesters, and childless couples to explore why they remain underinsured, entitled, "101 Excuses Not to Buy Life Insurance" (2007,

LIMRA International Inc.). The findings are summarized on the next several pages.

Life insurance prospects have many unresolved issues with the process of purchasing products, which help to explain their inertia and lack of motivation. One need not be in the life insurance business very long to hear all of the above reasons for not buying, and of course, many more. Understanding how people feel about life insurance and the process of purchasing will help you relate to prospects and find ways to help them take positive action. As the old saying goes, “life insurance is not bought, it is sold.”

Reason	Major Reason	Minor Reason
Dread high-pressure tactics	60%	26%
Have other financial priorities	55%	28%
Prefer other financial products	25%	48%
Can't afford	21%	46%
Difficult to decide what type	46%	38%
Difficult to decide how much	44%	39%
Worry about making wrong decision	36%	43%
Don't know who to buy from	31%	34%
Haven't gotten around to it	34%	33%
No one has approached me	21%	26%
Unpleasant to think about dying	6%	39%

#### ***Why Are Prospects Unlikely to Buy Now?***

Prospects are unlikely to buy now for the following reasons.

***The Topic Is Unpleasant and Stressful.*** Many react to the topic of life insurance with an array of negative emotions. They say it is boring, hard to understand, difficult to do the math, scary to think about, and makes them feel old. These feelings keep them from even starting the process. Life insurance is something they feel they can put off and buy tomorrow.

***They Feel Overwhelmed.*** Individuals feel there are too many decisions to be made when buying life insurance. It is complex and confusing. There are too many choices. They don't know what type or how much to buy.

***They Do Not Understand the Basics.*** Many lack even basic knowledge of life insurance. They don't understand why they need it, the different types, how much is needed, or how the policies work.

***They Procrastinate.*** Some people feel they are too busy and do not have the time to buy life insurance. Some are waiting for someone to approach them. Some will do it tomorrow.

***They Mistrust the Distribution System.*** Some individuals want help, because they know it is a complex topic and they do not understand it. However, they question whether an advisor will take the time to understand their needs or have their best interest in mind. They feel that advisors will not always suggest the best product for them, but the best product for the advisor to sell to them. This may be because they have not had contact with advisors, or because they have had negative experiences with sales representatives in the past. They are afraid advisors will "hammer away for hours" and not leave their home until they close the sale.

***They Do Not Have a Trusted Advisor.*** They do not have a trusted advisor to turn to or who contacts them on a regular basis. Most see an advisor as "a necessary evil."

***They Resist Approaches.*** Many ignore the industry's attempts to reach them. Direct mail advertisements and inserts in their bills leave them cold. They dread advisors calling them, even though they recognize they need more life insurance. If you call, they just say they are busy and hang up.

***It Is Not a High Priority.*** It is difficult to find extra dollars for life insurance when there are so many other pressing financial needs. They want to use the money in other ways that provide more immediate gratification, such as an HDTV, a vacation, or a new car. Most will not admit that life insurance competes against consumer comforts, so they say they need to replace household necessities like a furnace; buy other insurance, such as homeowners or health; or save for retirement. They are willing to take the risk for now. They do not understand risk management concepts when it comes to life insurance.

***They Have Family Expenses.*** For those with children, much of their extra money goes towards expenses for the kids, like private school, sports, music lessons, and orthodontics. All these activities and needs are seen as just as important as life insurance. They see the need to spend on purchases that will provide immediate results versus something that they may or may not need. When making trade-offs for their disposable dollars, some are

willing to risk financial disaster in the event of death, which might not happen, in order to provide value for the family today.

### ***What Has Worked in the Past***

Key triggers that have motivated people to buy in the past include the following.

***Life Events.*** Having children is a common motivator; so is purchasing a home. Reaching prospects after key life events, such as the birth of a child or a home purchase, is still a successful strategy. Listed below are life events you may choose to focus on

- having or adopting a child
- getting married
- buying a home
- taking on debt
- changing jobs
- making changes in marital status
- planning for college
- planning for retirement
- death of a loved one
- supporting aging parents

***Intervention.*** Some individuals buy life insurance only because others intervene and initiate the process, such as parents who encourage the purchase, advisors who contact them, or advisors who meet with them socially. Unfortunately, most of the individuals in this underinsured group have not seen or heard from advisors in years.

***Trusted Advisor.*** Trust is vital to the life insurance purchase process, and consumers are more likely to buy if their advisor is recommended to them by someone they trust, or if they already have a relationship with the advisor. However, finding a trusted advisor can sometimes be difficult, risky, and time consuming.

***Life Experience.*** People who experience or observe the consequences of the premature death of a parent, spouse, friend, or relative are more motivated to have adequate life insurance coverage. However, this does not mean they will proactively seek out the additional life insurance coverage they believe they need.

### ***What Is Not Working***

Confused messages from the industry over the years have helped create very resistant consumers.

***Advertisements.*** For many, advertisements are not memorable and do not provide useful information. This is especially true for those under 45, who feel life insurance ads are directed towards their parents and grandparents, so they do not pay attention to them. They do not remember or even understand the ads.

***Do You Still Sell Life Insurance?*** With company name changes, the broadening of product lines, and mergers and acquisitions, consumers are confused about who is still in the business of selling life insurance. Does XYZ still sell life insurance?

***Lack of Personal Contact.*** The current face-to-face model is not connecting with the underinsured effectively. Lack of regular contact with an advisor significantly reduces the likelihood an individual will obtain enough life insurance. Few underinsured individuals have a life insurance advisor, and positive experiences with advisors are rare. Lack of agent contact and lack of meaningful company contact exacerbate distrust of the industry and its sales representatives. Policyowners do not understand what they own and are not aware of new product options available. It is difficult for them to seriously consider additional coverage when they do not understand what they already have.

***You Don't Listen.*** Consumers depend on the integrity of the advisor to give them reliable information, options, and suggestions that meet their specific needs. Sometimes we do not listen. Start with what they want and what concerns them. Be patient. Listen to the prospect first.

***Rush to Close.*** Advisors either do not want to spend the time or do not understand the importance of building relationships with their prospects before trying to close sales. Pressing to close a sale in one meeting does not sit well with many consumers. They feel they need more than one contact, with time between meetings to review the options and suggestions. When the prospect is a stranger, the advisor has to spend time building a relationship before rushing to sell. When advisors appear to be too eager to close the sale, prospects believe they are not interested in what is best for them, and are only thinking about the commissions.

***Scare and Guilt Tactics.*** People find it distasteful for advisors to make leading statements that are insulting and demeaning. Telling someone they

do not love their family because they will not buy life insurance is not a good relationship-building tactic.

### ***What They Want***

Prospects want the buying and selling/planning process to be easy and pain-free. Some critical factors that have an impact on whether they will buy are as follows.

***Simple and to the Point.*** They want plain, blunt talk, and they want the terminology used to be easy to understand. They desire a short meeting with an advisor who will listen to them and talk about what they need, not what you want to sell them. They have busy lives and do not want to spend hours talking with an advisor. An hour is suggested as a reasonable time for the advisor to give them the information they need. Prospects have three basic questions they want answered when buying life insurance:

1. What is it?
2. What do I get?
3. What do I pay

***No High Pressure.*** They do not want to deal with anyone who uses high-pressure sales tactics. While they prefer to buy face to face, they will consider alternatives to meeting with advisors, such as seminars or buying through the worksite, which they believe offer low-pressure sales environments.

***Someone I Can Trust.*** They want to deal with advisors they can trust and who can help them with the buying process. Face-to-face contacts allow them to ask questions, look the advisor in the eye, and make a personal assessment. You must show them that you are interested in them, understand what they need, want to build a relationship, and are willing to educate them.

***Understand MY Situation.*** They want the advisor to understand not only their life insurance situation, but also their financial situation. They want multiple options, so they can buy what they can afford now, and add on to it later.

***Appealing Products.*** They want products that are simple and straightforward. They are motivated to buy insurance for the traditional purposes of protecting the home, replacing income, paying final expenses, and providing for their children's education.

## Prospecting Methods

There are three categories of potential contacts: (1) people who know you favorably, (2) people recommended by those who know you favorably, and (3) people who do not know you at all. Now let's consider the most common prospecting methods used to find people in these three categories.

### *Referrals*

Successful advisors have found referrals to be the most efficient and effective means of generating a perpetual supply of prospective clients. Referrals are people to whom you are introduced in one fashion or another, by someone who knows and values your work. Think of referrals as *borrowed trust*. Obviously, trust must be earned. That is why a relational, client-focused approach to sales is critical in creating a perpetual prospecting machine.

In their highest form, referrals are unsolicited. This is when the client enthusiastically tells people about you and compels them to call you in the same way they tell friends about a must-see movie. While this does happen, and the more it happens the easier selling becomes, until you can build your business, you will need to solicit referrals and not rely on word of mouth.

The effectiveness of referrals is unquestioned, because a referral from your client is a strong endorsement of your work. Compare that to a cold call, where the person does not know you and has no reason to trust you. People do not like to do business with total strangers.

To be referable, your clients must see value in you and what you do. You must communicate the idea to them that you would like to pass along the benefit of your services to people they value. You want to become referable, and selling a product does not make you referable. Taking a person through a valuable and memorable process does. Trust is the basis of any professional relationship. If you have demonstrated your trustworthiness to the client and developed a relationship based on this trust, and the client recognizes it, you will become referable.

***When to Ask for the Referral.*** There are many opportunities during the normal course of a sale to ask for referrals. They include

- after the sales interview is complete, when you have demonstrated your service and value, and established rapport and trust with the client
- at policy delivery, when you have satisfied your client with your professionalism
- when you provide a service to your client
- when you conduct an anniversary review

Some say you should constantly request referrals. If you receive a warm response and good referrals, continue this approach. However, be careful in creating tension for the client. High pressure can lead clients or prospects to suspect you will do the same to the referral, which might have a negative impact upon the relationship with the people they refer. They will not give you referrals if they feel this way.

Look for signs that the client values your work. The most obvious time is when they agree to buy the product. However, look for other moments in the selling/planning process that point to their perception of you as a trusted advisor, regardless of whether or not they purchase a product.

***What You Should Say.*** If you fail to plan, you plan to fail, so think about what you want to say and put it in writing. This will eliminate the fear of not knowing how to ask. Here are some things to keep in mind as you develop your script:

1. Reflect the value the client has received from the process. Probe for this information by asking what he or she has found helpful about this product.
2. Explain that you consider the client's stated value of the process extremely important.
3. Ask if there are people in his life who may need and value the same service.
4. If the prospect stumbles, present some alternatives with a simple, "Do you know someone who..." and fill the blank with a description of what you are looking for in a prospective customer. Use a description of a prospect from your target market or natural market.

### ***Centers of Influence***

#### **centers of influence**

A variation of the referral process is the center of influence. By definition, *centers of influence* (COI) are those influential people you know, who know you favorably, and who agree to introduce or refer you to others. Clients may become effective centers for you, just as COI may become clients, but this is not necessary to the relationship you need to establish.

In general, you will find that COI

- are active in a community or sphere of influence
- are sought out for advice by the community or within their sphere
- seek to communicate with others
- are givers, not takers

COI know you well enough, and have enough confidence in you, to refer you to prospects. An important aspect of a COI is that they have a personal

interest in helping you succeed. They may or may not be clients. They may be a friend of the family or someone you have worked with in the past, either in business or in a community activity.

Like any other relationship, COI must be cultivated. You must think of the person's interests and needs, and what you can do for them. You will find your COI willing to promote your cause if you promote his or her interests in return. Think of this process as a two-way street. It is a cooperative effort in which there is something in it for both parties, not just something for you. It is best if there is something of direct benefit for the referrer. Remember that he or she should be pleased with their relationship with you, and that you have earned the right to his or her help. This type of relationship often takes time to develop.

Your key to letting people know who you are and where to find you is your social mobility. Social mobility means being involved in your community and giving people the opportunity to see you working for common interests. If you think about it, you will recognize that the places where you have social mobility are also the places where you have prospects and COI.

### ***Networking***

Networking is the process of continuous communication and sharing of ideas and prospect names with others whose work does not compete with yours, but whose clients might also be eligible to become your clients. Conversely, your clients may need their products. It's a two-way street.

### ***Cold Canvassing***

Cold canvassing is challenging, time consuming, and rarely as productive as getting referred leads from clients or COI. There are many times, however, when going out and knocking on doors can generate some new and exciting situations that might not otherwise have occurred. Many advisors make successful use of canvassing as part of their prospecting repertoire.

### ***Speaking to Groups***

An opportunity that puts the advisor before someone's club meeting, association luncheon, church circle, or neighborhood gathering can be an informal group presentation or a highly structured seminar event. They are both good ways to get started in the mass marketing of your products. Seminar selling provides you with an opportunity to gather a group of people together so you can present ideas that address problems and concerns common to the group members. You will want to arouse interest in your

products and services, so individual appointments will follow and lead to sales.

### ***Direct Mail***

Direct mail will get your name and your company's name in front of as many people as you wish. Hopefully, it will isolate those who are ready to talk about insurance. You can get your message in front of people who might not be available to answer your phone call or your knock on the door.

The most important point to remember about direct mail is that it only works if you use it regularly. Inconsistency will not work. It must have ample chance to succeed and you must follow up on each mailing. When used regularly, you will generate leads and interest in your products and services.

### **Approaching the Prospect**

The next step in the selling/planning process is approaching the prospect. It is the process of obtaining the prospect's consent to see you about the services you provide, as well as setting the date, time, and place of the appointment.

It is a rare life insurance buyer who both recognizes a need and initiates the purchase. A very old industry expression states that life insurance is sold, not bought. This reflects the need for the life insurance advisor to initiate the sales process. It is important to recognize the tendency for procrastination, lack of knowledge, and denial of need with which prospects approach life insurance. The role of the insurance advisor is to use the client-focused sales approach to help a person recognize and accept a need, and to seriously consider resolving that need.

Effective and successful selling begins with getting in front of quality prospects on a consistent basis. You want to look for individuals that have a high probability of being qualified prospects. You want to find people who will value you and what you can do for them, and who will be a source for repeat business and referrals. A systematic approach will help you find target markets of potential buyers and will enable you to market efficiently and effectively.

The advisor must have a constant flow of prospects. It is an ongoing activity and must be attended to daily to maintain the flow of potential customers. Everyone who is successful at marketing and selling life insurance has a means to gather and organize names. They collect them consistently and systematically, so that they have new people to call every day, people who may be interested in addressing their financial concerns.

---

## CHAPTER THREE REVIEW

---

*Key terms and concepts are explained in the glossary. Answers to the review questions and the self-test questions are found in the back of the book in the Answers to Questions section, following the Glossary.*

### Key Terms and Concepts

evidence of insurability	decreasing term insurance
adverse selection	payor benefit
renewability	increasing term insurance
convertibility	one-year term option
attained age	return-of-premium (ROP) term
retroactive conversion (original age)	marketing
re-entry term	selling
select mortality	target marketing
ultimate mortality	qualified prospect
level term	center of influence

### Review Questions

- 3-1. Describe the basic nature of term insurance.
- 3-2. Describe the variations of term insurance.
- 3-3. Describe the protection provided by renewability provisions in term life insurance contracts.
- 3-4. Compare the attained-age method of converting term insurance with the retroactive conversion method.
- 3-5. Explain why there are time limitations on conversion rights for term insurance, and describe different forms of such limits.
- 3-6. Explain how select and ultimate term (re-entry term) differ from traditional forms of term insurance.
- 3-7. How do term-to-65 policies differ from shorter duration term life insurance contracts?
- 3-8. Describe the most common situations for which term insurance is suitable and useful.
- 3-9. Differentiate marketing and selling, and the objectives of target marketing.
- 3-10. Briefly discuss methods of prospecting.

**Self-Test Questions**

*Instructions: Read Chapter 3 first, then answer the following questions to test your knowledge. There are 10 questions; circle the correct answer, then check your answers with the answer key in the back of the book.*

- 3-1. Term insurance policies always provide
- (A) a benefit only at the end of the term
  - (B) only temporary life insurance protection
  - (C) a small cash payment at expiration
  - (D) convertibility within the term to another plan of insurance
- 3-2. Re-entry term insurance allows insureds to keep a select premium rate after the initial period if:
- (A) they meet underwriting standards
  - (B) they are under the age of 40 at initial application
  - (C) mortality tables do not increase more rapidly than 10 percent per annum
  - (D) the company still issues insurance in that policy series at subsequent 5-year intervals
- 3-3. Which of the following statements concerning YRT is correct?
- (A) The insurance company may experience some adverse selection at renewal time.
  - (B) The premiums do not increase from year to year.
  - (C) Evidence of insurability must be furnished at the time of each renewal.
  - (D) The insured can renew the policy each year by completing a medical exam.
- 3-4. The tendency for healthy individuals to give up their insurance as its cost increases, while those in poor health continue to renew regardless of its cost is referred to as
- (A) risk pooling
  - (B) risk tolerance
  - (C) adverse selection
  - (D) YRT

- 3-5. Which of the following statements about marketing and selling is true?
- (A) Selling is planning and marketing is exchanging the product for money.
  - (B) Marketing and selling are one and the same.
  - (C) Marketing is more important than selling.
  - (D) Selling is the end result of successful marketing.
- 3-6. Which of the following statements are arguments in favor of term insurance and against level premium insurance by those who advocate buying term insurance?
- I. Level premium insurance overcharges the policyowner.
  - II. The accumulation and protection elements should be separated.
- (A) I only
  - (B) II only
  - (C) Both I and II
  - (D) Neither I nor II
- 3-7. Which of the following statements concerning re-entry term insurance is (are) correct?
- I. The initial premium is based on an ultimate mortality table if the insured's health is better than average.
  - II. Future premiums will be based on a select mortality table if satisfactory evidence of insurability is periodically provided as required by the insurer.
- (A) I only
  - (B) II only
  - (C) Both I and II
  - (D) Neither I nor II
- 3-8. All of the following statements regarding term insurance are true EXCEPT
- (A) If the term is converted as of a current date, it is called an attained age conversion.
  - (B) Renewability allows a renewal without a medical exam, but the premium may increase.
  - (C) Re-entry term is based on select and ultimate rates.
  - (D) Term insurance allows for two types of conversions, original age and retroactive conversion.

3-9. All of the following statements concerning term insurance are true EXCEPT

- (A) Term insurance is comparable to property insurance in that both provide coverage for a limited time.
- (B) Term insurance policies always provide protection from a certainty (death).
- (C) The chief function of the renewable feature in term insurance is to protect the insurability of the insured.
- (D) There is an adverse selection opportunity against the insurer at each renewal.

3-10. All of the following statements concerning yearly renewable term insurance are true EXCEPT

- (A) The premium is determined by the death rate at the insured's attained age.
- (B) The right to renew coverage may be limited to a specified age or period of years.
- (C) The policyowner must furnish evidence of insurability to renew coverage.
- (D) The face amount of the coverage is paid to the beneficiaries at the death of the insured.