Life Insurance – Student Guide

Does life insurance insure your life? Not exactly. But you're insuring a very important part of your life – your income and the financial stability it provides your family.

Think about the present. If both of your parents work and one of them dies, who would support you? Would you be able to live in the same home? Who will pay the bills?

Now think about the future. If at some point in the future you and your spouse took out a car loan or a home mortgage together, what would happen if you died? Who would pay for your funeral?

In any situation where you're responsible for someone or something, life insurance helps make sure there is enough money to pay your bills and meet your family's needs after you are gone.

What is life insurance? How does it work?

Life insurance helps protect your family against the loss of your income when you die. The insurance policy's death benefit is used to provide income to your surviving family. It can also be used to pay off your financial obligations, as well as funeral expenses and burial costs.

When you buy life insurance, you pay your insurance company money (your premium), and they in return agree to pay a death benefit to whoever you choose when you die (your beneficiary). A beneficiary is usually a spouse, a child or a parent. Your beneficiary can use the money for any purpose, but the main reason for buying life insurance is to make sure your family is taken care of, any money you owe is paid, and all of your bills are settled.

Ask yourself:
Did you know even a simple funeral can cost more than $10,000? How would you be able to pay for a loved one's funeral without life insurance?

Aren't I too young to worry about life insurance?

You're probably years and years away from dying. But, the simple fact is anyone at any age can die. Car accidents, natural disasters, fires and many diseases aren't picky when it comes to the age of their victims. Your parents may already have a life insurance policy on you as well as themselves.

How much life insurance is enough?

There's no easy answer. The first step to finding out is usually by talking to an insurance agent and discussing your situation. He or she can help you look at things objectively and help you determine how much money your survivors would owe on your home, cars, credit cards, etc.

You should also factor in the cost of funeral expenses and, if needed, money to provide an income for your family and your children's education.

After reviewing your needs, your agent will propose a life insurance policy and amount of coverage. Then, you pay a certain amount of money for the policy (a premium) monthly, quarterly or annually, and the policy pays a specific amount (the death benefit) when you die.

How much does life insurance cost?

How much you might pay for life insurance compared to someone else depends on several factors. But as a general rule, life insurance costs less for a younger person and more for an older person. And the longer you wait to buy life insurance, the more expensive it gets, if only because the probability of dying generally increases each year.

Of course, age isn't the only key factor insurance companies consider. Insurance companies use statistics from years of research on a large number of people to help determine the cost of your insurance. They use these statistics to develop mortality tables, which list the probability of a person's death based on certain characteristics, including age, sex and tobacco use.

Other factors, called risk factors, aren't in the mortality table but can be used to determine how risky it will be to insure your life since they probably will affect how long you live. Examples of risk factors include current health, job, hazardous activities or hobbies, alcohol and drug usage, medical history and weight. And if the insurance company considers you a high risk, they might charge you more for coverage, or they might not insure you at all.

Ask yourself:
You're a 350-pound skydiver with a history of cancer. Are you a higher or lower risk than a 180-pound teacher with no medical problems?

What types of life insurance are there?

Life insurance policies typically fall into two general types of coverage: term life insurance and permanent life insurance.

Permanent life insurance provides coverage throughout the insured's lifetime as long as premiums are paid as required. One permanent life insurance policy can cover your entire life. The premium can be fixed or flexible.

A permanent life insurance policy also has a cash value which builds over time. You get this money if you cancel the policy. You may also be able to take a loan against the policy's cash value, and the loan plus any unpaid interest would be subtracted from the policy's benefit if you die.

Types of permanent life insurance policies include whole life (the most common), universal life, variable life and variable universal life.

Term life insurance provides coverage only for a specified period of time. It provides a death benefit if you die during the policy term. The policy term is the specified period of coverage provided by the policy – it can be as short as an airplane trip or as long as 40 years. Most policy terms are for a number of years – one, five, 10, 20 or until a certain age is reached. If the term expires before you die, your beneficiary receives nothing.

A term life insurance policy generally has no cash value, and therefore you receive no money back if you outlive the term or cancel the policy. Many people purchase term insurance to cover a specific period when their income is particularly critical to those they'd leave behind. For example, people buy term insurance to cover payments on a house or their children's education costs. A term insurance policy may contain a right to convert the policy to a permanent insurance policy, typically before a specified age or time period.

Insurance policies may also include supplemental coverages, or riders, that tailor a policy to an individual. These may include disability coverage which helps protect against loss of income due to sickness or injury, or accidental death benefits which pay an additional benefit to your beneficiary if you die as the result of an accident.

Terms to know

Accidental death benefit – If a person dies as the result of an accident, the insurance company will pay an additional death benefit to the beneficiary.

Agent – A person who sells insurance; your direct contact with an insurance company.

Beneficiary – The person or people designated to receive the death benefit from a life insurance policy when the insured dies.

Cash value – In a permanent life insurance policy, the amount of money the policy owner will receive if the policy is cancelled and surrendered to the insurance company, unless there is an outstanding loan.

Claim – A request for payment under the terms of the insurance policy.

Death benefit – The amount of money paid when a person insured under a life insurance policy dies.

Insured – The person receiving insurance coverage under the insurance policy.

Insurer – Another term for the insurance company.

Policy – A written document that serves as evidence of an insurance contract which contains the pertinent facts about the policy owner, the insurance coverage, the insured and the insurer.

Premium – The amount you pay in exchange for insurance coverage.

Assignment:

Term vs. "Perm"

Look over the following examples and answer whether the type of life insurance described is term life insurance or permanent life insurance. Your teacher will review each example with your class once you've completed the assignment.

1. Dan Cooper's life insurance coverage expires on Dec. 31, 2020.
2. Doris Mann's policy from Acme Insurance Co. currently has a cash value of $4,782.68.
3. Grady Fillmore wants to make sure his life insurance proceeds cover his funeral expenses and all outstanding debts when he dies, so his family won't have to incur the expenses.
4. Alice Yates' life insurance policy doesn't have any value unless she dies during the policy term.
5. The XYZ Life Insurance policy Ruby Wannamaker's parents purchased for her when she was born will cover her for her entire life as long as the required premiums are paid.
6. Leo P. Conrad purchases a second life insurance policy to make sure his children's educational expenses are covered in the event he dies before they graduate.
7. June Beaver timed her supplemental life insurance coverage to expire right after she and her husband pay off the mortgage on their home.
8. Crazy Charlie Seaver took a $5,000 policy loan on his life insurance coverage, so he'd have plenty of spending money in Las Vegas.