LIFE INSURANCE: A PRACTITIONER'S PRIMER

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Introduction

To many lawyers life insurance is a necessary evil that the lawyer must contend with in his own personal estate planning and a complicated maze of options for the client. The purpose of this article is to help practicing lawyers understand some of the basics of life insurance. Many life insurance companies sell Annuities and Health or Sickness or Disability Income Insurance as well, but this article will not deal with these products.

Many life insurance companies stoutly maintain that their business is different from any other business. Unfortunately while they do not proclaim this to their clients, the aura of mysticism of life insurance does flow over into the products they sell. It is part of the problem of why understanding life insurance is difficult. An obvious difference is that the life insurance companies have their own terms which adds to the confusion.

In concept life insurance is very simple. It is merely a promise to pay a certain amount of money on the death of a person.[1] Unfortunately the modern life insurance policy is much more than this. It is bound up in many pages of paper with many options and riders. Take the case of a lawyer receiving a call from a life insurance agent. The agent advises the lawyer that his client five years ago bought a special Executive Plan Reducing Term to Age 60 Nonpar with extended benefits and Family Income Riders. The agent announces that the client should now change this to have the client's company purchase a new special New Money Rate Ordinary Life Par with Auto Paid Up Additions. The client has requested the lawyer's advice. Many lawyers will be immediately confused. They are on strange ground. At best, they will become defensive and ready to defend against anyone. Unfortunately they are not sure what they are going to defend against.

For a moment consider another telephone call, this time from a Real Estate agent advising the lawyer that his client is considering buying an apartment block. Now the lawyer is on familiar ground. He knows all the legal tax and business problems that must be ex-

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1. Defined in *The Insurance Act*, R.S.M. 1970, c. 140, s. 2(32) as

   insurance whereby an insurer undertakes to pay insurance money
   (i) on death; or
   (ii) on the happening of an event or contingency dependent on human life; or
   (iii) at a fixed or determinable future time; or
   (iv) for a term dependent on human life,

   and, without restricting the generality of the foregoing, includes accidental death insurance but not accident insurance.

amined. The client knows exactly why he is buying the block. There are still many questions but at least the questions are known and understood.

Returning to the conversation with the life insurance agent, the chances are the client never really determined what his life insurance needs were when he bought the first policy. He may have known he needed insurance and the total amount, but that was all. The agent probably tried to spell out the needs more clearly and many agents do a good job of this. The fact remains that few clients really understand why they are buying a particular policy ahd have no strong demand to buy it. When it comes to changing one type of policy to another, the problem is compounded because usually the client cannot remember why he bought the original policy in the first place.

Much of the problem lies in the complexity and multiplicity of the options available with a life insurance policy. When buying a car, while the list of options may be endless, the benefits of each are readily understood. When buying a life insurance policy, the purpose of each option is rarely understood and the benefit of one option over another is sometimes difficult to determine. To add to the problem, a term used in one policy may mean something else in the policy issued by another company. Fortunately life insurance policies have few exclusions; but options, riders, and additional benefits will have exclusions which should be carefully scrutinized.

A Glossary of Terms

But all is not lost. The lawyer can help the client. The exercise may also help the lawyer with his personal problems as well. The biggest problem is understanding the terms. At the moment a study is being made by the life insurance industry in the hope of changing terms used now to terms that are more in line with everyday usage. Until this happens here are some common terms that may help:

Premiums: These are not bonus coupons but the payments that are required to be made to keep the policy in force.

In Force: A policy that has not lapsed or terminated.

Par Policies or *Participating Policies*: These are life insurance contracts on which dividends are paid. If the expenses incurred by the company are less than expected, or fewer policyholders died last year than expected, or the company investments yielded higher returns than expected; a higher than expected profit is generated and a portion of this is returned to the Par Policyholders as dividends. Nonpar or Nonparticipating policies do not pay dividends.

Dividends: A distribution by the company of these extra profits. A client can choose to use these dividends to reduce the premium payments, take them in cash or increase the amount of his insurance coverage.

Ordinary Life or *Individual Life Policies*: These are a broad category of life insurance policies such as a client takes out on his life.

Third Party Insurance: In these policies, the owner of the policy is different from the person whose life is insured. For example, a wife may take out insurance on her husband's life. The beneficiary could be anyone.

Insured: This is a confusing term, since it could be the person whose life is insured or the person who is the owner of the policy.[2] Many companies try to stay away from the use of this term and instead use the term "The Life Insured" or "The Person Whose Life is Insured."

Riders: These are extra features or options to the basic contract. They provide various types of benefits. They may even provide insurance coverage on other people such as the policyholder's wife or children.

Cash Surrender Value: This is the amount of money that in some policies builds up over the years. This becomes available if the policy is cancelled or if a person wants to take out a loan on the policy or to use for payment of the policy premiums.

Guaranteed Insurability Benefits: This is a common type of rider where the company guarantees that the person whose life is insured can purchase more insurance at a future date usually at fixed rates and normally with no medical examination being necessary.

New Money Rates: These are new types of plans which guarantee for a limited number of years increased investment returns to the policyholder. Unfortunately there are some unpalatable side effects.

Term Insurance: These policies expire or terminate on a fixed date. If the person whose life is insured dies after that date, no benefit is paid.

Permanent Insurance: This is the opposite of *Term Insurance*. The coverage usually extends for life.

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2. Defined in *The Insurance Act*, R.S.M. 1970, c. 140, s. 2(30) as "a person insured by a contract whether named or not."

Endowment or *Limited Pay Life* or *Life Paid Up to 65*: Premiums on these types of policies are paid only to a fixed date while the insurance coverage will in some cases continue beyond the date of the last premium.

Straight Life: The premium payments continue as long as the insured lives.

The Lawyer's Approach

This list of terms is basic only. It is essential to an understanding of a life insurance policy that each term be fully understood. If the lawyer does not want to show his ignorance before his client, he should talk to the agent in advance.

Having determined what the words in the policies say, the next step is to determine what the benefits and options are. This is particularly important when trying to decide whether to exchange one policy for another. First, the benefits and options on the existing policy should be listed, together with such questions as: What is the present amount of insurance? Does it change in the future? Is there a right to buy more insurance? Under what conditions? What are the premiums? How long do they continue? So far as benefits are concerned, how much is the cash surrender value? How much does it increase in each year over a five-year period? Are there dividends and how much are they? What are the options for the use of the dividends? How are they presently being used? So far as premiums are concerned, the lawyer must ask who is paying the premiums and whether the monies used are after tax or before tax money? Is there a loan against the policy, how much, at what interest rate, and with whom? Finally, a question must be asked as to what was the intended use of the benefits of the policy when it was first purchased?

A second list should then be made, probably with the help of the agent, to identify the needs of the client. The agent may be able to state these, but it is important that the client understand and recognize that these needs are something that he must cover and, more important, is able to afford.

The final list should set out what the proposed policy will do for the client. The same questions that related to the existing policy should be asked with regard to the new proposed policy.

The agent is the primary source for answers to the above questions. Although he has been in some cases much maligned, the good agent is anxious to inform and to assist the client in making the right decision. Agents are normally paid by way of commission. Unfortunately at the moment there is no escaping the payment of commissions. They are buried in the premium. Commission rates are not standard among companies but they are generally in the same range. Some types of insurance plans pay higher commission rates than others but the insurance industry is seeking ways to eliminate these differences. If you are concerned about the amount of commission, ask the agent.

It is also important to make a comparison of premiums. There are many ways to do this, none of which are perfect. The life insurance industry has adopted an interest adjusted method based on the cost per thousand. The cost per thousand of many life insurance plans is available using this standardized approach. Premium rates do vary between companies and the agent can give comparable rates not only for his company but likely for many other companies. A word of caution, however, and that is to be sure you are comparing the same types of plans with the same benefits.

What sort of problems does your client face in the future with regard to his policy? Again, life insurance companies are different from other insurance companies in that they accept the certainty that, so long as the premium is paid and the client dies before the maturity of the policy, the company will have to pay out the benefit. It is only a question of whether the benefit will be paid this year, next year, or the year after. This results in a different attitude towards payment of the claim than in the attitude of other types of insurance companies. This does not say that the life insurance company is anxious to pay out the benefit, only that the problem at claim time is usually more quickly dealt with. Did the person whose life is insured die or not? Who is the beneficiary? What is the amount due? In the normal case, these answers are readily available and the claim should be paid quickly.

What is the outlook for the future? Fortunately for the lawyer and the client, the life insurance industry may solve some of the problems. Considerable effort is now being made towards producing policies that are simple in concept and written in language that a layman can understand. It will be several years before these policies are available. In addition, the industry is working very hard to provide agents who are better trained and who have a more professional outlook to their calling. Group insurance policies sold over the counter may well be the answer for some people.[3]

3. *See* R. Hasson, "The Reform of Group Life Insurance," *infra*.