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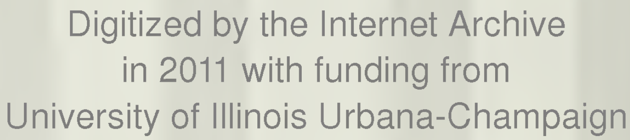
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Changing Life Insurance Needs *For Families*

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The Illinois Cooperative Extension Service provides equal opportunities in programs and employment.

Since the first life insurance policy was sold in 1583, families have been purchasing life insurance as part of their economic security programs. In fact, most families consider it a very important part of their program since it provides needed protection for the future. The amount of protection and the reasons for protection usually vary. Thus, it is very important that families understand life insurance and the role it plays in their economic security.

Three isolated incidents — the sound of screeching brakes on an interstate highway, a widow getting her first job at age 55, and a young man dropping out of college — brought three families to us asking for information on life insurance.

When Mr. Baron, who was on a business trip, heard the brakes screech and then watched the automobile crash that killed the parents of two young children, he began to think about his own family. What would happen to his two daughters if he and his wife were to die suddenly? Where would they live? Who would pay for their food, their clothing, the rest of their everyday expenses? He decided it was time for a talk with his wife.

Mr. and Mrs. Clark saw the "brave" look on their neighbor's face when she got her first job at age 55 shortly after her husband died. They saw her give up her membership in many organizations and sympathized with her when she said she was just too tired to join them for an evening's entertainment. They watched her try to make her small earnings pay the mortgage and buy her food and clothing as well as pay for her other living expenses. The Clarks decided they wanted some advice on providing for Mrs. Clark in case Mr. Clark were to die prematurely.

Bob Price couldn't believe it when he heard that Gary Williams, who was planning to be a doctor, had dropped out of college in his freshman year. This happened shortly after the death of Gary's father, who had been Bob's business partner. Bob found out that his partner had left just enough insurance to pay his burial expenses and to meet the mortgage payments. Since his widow needed some additional training before she could earn enough money to support the family, it was decided that the best solution was for the oldest son to interrupt his education. Bob Price didn't want that to happen to his wife and children.

The type of information we gave these three families concerning the use of life insurance protection to meet the changing needs of their families across the family life cycle is included in this circular.

LIFE INSURANCE GIVES PROTECTION

Usually families purchase life insurance for protection. They are buying financial protection for themselves in the event that the breadwinner dies before the children are grown. In addition, some families buy financial protection for the years after the breadwinner's retirement.

Since the father is usually the family breadwinner, most of the life insurance purchased by a family is on the father. Today, more and more families have two breadwinners. Therefore, the family may need to consider insuring both, since the loss of income of either breadwinner may seriously affect the family's financial security.

Life insurance is based on the law of large numbers. This means that a large number of families that share the common risk of losing the breadwinner pay a small amount of money (called a premium) each year. Then the dependents of those who actually die during that year receive a much larger amount of money than the annual premiums they have been paying. The life insurance company, as its part in the transaction, calculates the risk of the insured dying during the year (using mortality tables), collects premiums from the persons sharing the risk, and handles payments to beneficiaries of insured individuals who die.

The type of financial protection a family needs varies with family income, resources, goals, composition, and stage in the family life cycle. Used correctly, life insurance can make a valuable contribution to family economic security. When used unwisely, however, it can be an excessive drain on family finances and, indirectly, on family happiness and satisfaction.

FORMS OF POLICIES

Life insurance protection can be purchased in four different forms — ordinary, group, industrial, and credit. Different types of insurance policies — straight life, limited payment, term, endowment — are written under one or more of the different forms of life insurance.

Ordinary Life Insurance

This is the most-used form of life insurance in the United States today. It accounted for over half the total amount of life insurance in force in 1973. Families purchase ordinary life insurance policies on an individual basis from an agent, usually in amounts of $1,000 or more. They then pay premiums to the insurance company annually, semiannually, quarterly, or monthly. Most types of life insurance policies (straight life, limited payment life, term, and endowment) may be purchased on an individual basis as ordinary life insurance.

Group Life Insurance

This form of life insurance is available to a group of persons, usually through organizations such as businesses, industrial firms, or governmental units. Today many professional organizations are offering group policies to members.

Group life insurance is the second largest form in terms of the total amount of life insurance in force in the United States. Sometimes employers pay all or part of the cost of group insurance. Of the four forms of insurance, group life insurance costs the least for a given amount of protection, and is usually available without a medical examination. It is usually term insurance. When employees leave their company or group, often they are given the opportunity of converting the group insurance coverage into some type of permanent coverage on an individual basis. Many policies may also be continued into retirement, depending on the group plan.

Industrial Life Insurance

Industrial life insurance policies usually are issued for amounts under $1,000. An agent calls at the home of the policyholder every week or every month to collect the premiums. For a given amount of protection, industrial insurance is usually much more costly than either ordinary or group insurance. Part of the costliness is due to the high cost of premium collection. Also, people who take out industrial insurance tend to have a high mortality rate. In the past, industrial insurance was used primarily by the American worker who was not able to pay premiums once or twice a year. Today, this form of insurance is the least important in the United States, probably because of the increased ability of the American worker to pay larger premiums at less frequent intervals.

Credit Life Insurance

Credit life insurance is the fastest growing form of life insurance. It is usually issued through banks, retail stores, finance companies, or credit unions, and is used to guarantee that debts or loans will be repaid if the borrower dies. This type of policy protects the borrower and his family as well as the lender.

Illinois law sets a maximum on the amount that loan companies may charge for life insurance and health and accident insurance policies when these are part of the loan. When the borrower takes out credit life insurance as part of his loan, he must often pay interest on the premium.

In Illinois, the purchase of credit life insurance to insure a loan is not required by law. However, it may be required by the company issuing the loan. In addition, according to the Federal Truth in Lending

regulation, if credit life insurance is included as part of the finance charge, this fact must be disclosed to the consumer.

TYPES AND USES OF LIFE INSURANCE POLICIES

As indicated above, there are four basic types of life insurance policies. These are term, straight life, limited payment life, and endowment. Although there are many different names for policies, such as family income plan, retirement plan, and mortgage insurance, these are just combinations or variations of the four basic types of insurance.

Term Insurance

A term policy protects the policyholder's beneficiaries if he dies within a specified period of time stated in the policy. For example, if a person takes out a five-year term policy, the beneficiary has financial protection against the policyholder's death during the five years, but for no longer. If the policyholder still needs protection at the end of the five-year period and if he is still an acceptable risk, he can take out another policy.

Special clauses. Two special clauses are available which add to the cost of term insurance but which give the family the opportunity to continue protection beyond the term of the policy.

A renewable clause gives the policyholder the right to renew his policy without a medical examination for another period of time.

A convertible clause gives the policyholder the right to convert his term insurance to straight life or some other permanent plan.

Uses of term insurance. Term insurance will serve your family adequately only when your need for protection will expire at the same time as the term policy. For example, your family can use term insurance to advantage when you have a temporary need for extra financial protection. It can also be used when your family is temporarily pressed for money and term insurance is all you can afford if you are to obtain the amount of protection needed.

Examples of temporary need. A family that has a mortgage on its home can insure the life of the breadwinner for the decreasing amount of the mortgage. If the breadwinner dies, the home will be paid off in full. This type of insurance is often referred to as decreasing term insurance. With decreasing term insurance, the premium paid and the amount of coverage decrease over a period of time.

A father who depends on his current income to keep his child in college can insure his own life for the amount needed to complete the child's education.

The farm family in debt for equipment, machinery, or stock can insure the farmer's life so that if he should die the debt would be paid in full.

Temporary financial condition. Sometimes a family purchases term insurance because it fits its pocketbook rather than the family's needs. Often the family plans to convert the term insurance into a permanent policy form as more money becomes available for premiums.

Young couples, for example, who have only a small amount of money to budget for insurance but who have a large protection need, can use term insurance to advantage.

Established families, who need more protection against death than they can afford to purchase on a permanent plan, can use term insurance to obtain adequate protection against premature death of the breadwinner. However, this may mean that they must sacrifice, in whole or in part, old age protection for the breadwinner and his wife.

Straight Life

This is the basic type of policy which furnishes the maximum amount of permanent death protection at the lowest annual premium. Straight, or ordinary life as it is sometimes called, provides death protection throughout life with premiums payable continuously until the policyholder dies. This is a versatile policy, since it contains a savings element (cash value). With this type of policy the individual can protect against the twin dangers of premature death and of loss of income through old age.

Cash value. The cash value that the straight life insurance policy builds up may be used in several different ways. For example, it may be used to borrow money from the life insurance company. The loan must be repaid with interest, or the amount of the loan will be deducted from the face value of the policy upon death of the policyholder, thus reducing the benefits. The policy that has a cash value may also be used as security for a loan from a bank.

Many insurance policies have special clauses or options that allow the cash value to be used in other ways. If the policyholder can no longer continue to pay the premiums, the policy can be converted into a paid-up policy for a lower amount. Or the policy can be surrendered and the cash value taken in a lump sum. Sometimes the full amount of the policy can be kept in force for a limited time by converting to term insurance.

Limited Payment Life

In the limited payment type of policy, protection is for the entire life of the insured, but premiums are payable for a stated period of time,

such as 10 years, 20 years, 30 years, or until the insured reaches a given age, such as 60 or 65. For a given amount of protection the annual premium rate is higher for limited payment life than for straight life insurance, since premiums are paid only for a definite number of years. This means that the cash value of the policy builds up at a faster rate for the limited payment life than for the straight life insurance policy.

The major objection to limited payment life insurance is that some families may be building up a savings fund when the real need in their insurance program is for protection against premature death. Families should consider this point when selecting this type of policy.

Endowment

The endowment policy offers insurance protection against death for a specified period of time. This type of policy is like a savings fund protected by term insurance. The policyholder decides that he wants to build up a certain amount of money by the end of a given number of years. In a sense, the insurance company establishes a savings fund for him to which he contributes regularly and on which interest is compounded, usually annually. If the policyholder lives to the end of the specified period, he will have accumulated the amount of cash desired. If he dies before the end of that period, his beneficiary will receive the face amount of the policy.

The family that considers using the endowment policy should be certain that its need for protection against premature death has been fairly well filled. In addition, the family should have a specific need for cash at a given time in the future.

Perhaps the most important use of endowments is to provide retirement income. For example, if a man invests $125 a year in an endowment policy from the time he is 25 until he is 65, he will be providing $5,000 worth of protection for his dependents until he reaches 65. At that time he will start receiving $33.75 a month retirement income, which will continue for the rest of his life.

Sometimes an endowment policy can be used to build up a fund for paying off a debt that will fall due at the end of a given number of years. This is one means used to accumulate funds by those who find it difficult to save.

Limitations. The limitations of the endowment policy arise from its incorrect use. The temptation of having a large sum of cash at the end of a relatively short period of time leads many families to purchase this plan when their real need is for premature-death protection. The premium rate for endowment insurance is higher than it is for the other types of policies discussed above. Whatever happens, the policyholder pays for the portion of the policy on which he didn't collect: He pays

for the term portion if he lives, and for the pure endowment portion if he dies. If he dies, his family probably would have been better off with pure term insurance. If he lives, he probably would have been better off with a savings account.

SPECIAL POLICY FEATURES

Regardless of the type of policy or policies your family decides to buy, it is important to keep your plan flexible. There are special clauses that you can add to your policy to help keep it flexible. Two of these clauses, the *renewable* and *convertible clauses* available with term insurance, were discussed on page 6. Two additional clauses, which will add to the cost but which may help you to keep your plan flexible, are the disability clause and the guaranteed insurability clause.

The *disability clause* allows for a waiver of premiums if the policyholder becomes permanently disabled or unable to work.

The *guaranteed insurability clause* guarantees the policyholder the right to purchase stated amounts of additional insurance at specified times in the future without passing a physical exam.

These special features may help you to keep your plan more flexible, but they also add to the cost of the policy. Evaluate your family's insurance program to determine how the protection offered through these clauses fits your family's needs.

PAYMENT OF PREMIUM

The premium is the amount of money you pay each time interval in order to keep your policy in force. Many companies are computerizing the payment of premiums. In this instance you sign a card allowing the insurance company to bill the bank directly for your premium and allowing the bank to pay the bill without your signature each month. This way you never have to worry about making payments on time or missing payments. In most instances, the cost for this is less than having the company bill you quarterly.

LIFE INSURANCE NEEDS ACROSS THE LIFE CYCLE

The Single Person

A single person does not need much life insurance if he is self-supporting and has no dependents. In general, he should carry enough insurance to take care of his final expenses and to protect his creditors by covering his debts — loans for education, automobile financing, or a home mortgage, for example. Term insurance could be used for all of these except final expenses.

Sometimes the young single person will be encouraged to buy insurance early in order to get lower premiums. It is generally true that, the younger the insured, the lower the premiums for a given type of insurance. One reason is that the savings part of an insurance policy is spread over a longer period of time. (This does not apply to term insurance, which builds up no savings.) In addition, the younger the person, the lower is the risk of his death. However, the single individual may be paying for protection he does not need just to get lower premiums throughout life.

If the single person has dependent aged parents, he may wish to provide financial protection for them in the event of his death. This need for protection could apply during any stage of the family life cycle.

Establishment of the Family Stage (No Children)

Insurance needs of the newly married couple with no dependents are very likely the same as for the single person.

The businessman, the professional man, or the farmer who borrows money to get established — to purchase equipment, supplies, or livestock, for example — should cover loans with insurance to protect his wife as well as his creditors. Term insurance should be considered to fill these needs.

The couple that purchases household equipment and furnishings, an automobile, or other merchandise on the deferred payment plan should consider the purchase of decreasing term insurance to cover the period of the loan. This type of insurance can also be used for mortgage protection if a home is purchased on the deferred payment plan.

In this stage of the family life cycle, the couple should try to save for the future. Often the wife and the husband are both working. Some couples try to live only on the husband's income and save the wife's for emergencies or for expenses expected later when the children are born or when a home is purchased. While insurance (especially endowment insurance) can be used to save for the future, families should investigate other forms of savings before purchasing policies.

Savings probably can be invested more profitably in other safe and conservative ways than in insurance. For example, the table on the next page shows how $100 a year invested in a savings account, left to accumulate at an interest rate of 5 percent per year with interest compounded annually, increases in value through the years.

Another way to save regularly is to use payroll deduction plans to buy government savings bonds. This method is especially helpful for couples that find it difficult to save money on their own.

Growth of $100 a Year at 5 Percent Interest Compounded Annually and Left to Accumulate

At the end of:	Actual amount deposited	Amount in account
1 year	$ 100	$ 105
5 years	500	553
10 years	1,000	1,257
20 years	2,000	3,307
30 years	3,000	6,644
40 years	4,000	12,080
45 years	4,500	15,970

By comparison, how much insurance will $100 a year buy? This information is provided in the table below. In the long run, the savings account will be more profitable for the family. However, in the short run, the insurance policy provides the advantage of protection in case of death.

*Life Insurance Protection Provided by $100 a Year Starting at Age 20**

Policy	Amount of protection	Cash value at age 65
Term to Age 65	$16,782	None
Straight Life to Age 65	7,231	$3,769
Limited Pay Life Paid Up at 65	6,468	4,470
Endowment Maturing at Age 65	5,650	5,650

* Approximate values under a nonparticipating policy — one that pays no dividends.

Preschool and Elementary School Stages

While the children are young, the death of the father usually is the greatest hazard faced by the family. Even though the young mother may be working or may be able to provide income for the family if the father dies, it is more difficult for her to leave home during the preschool and elementary school stages than at any other time during the family life cycle. Therefore, young families usually need a great deal of income protection from life insurance. At the same time, they have relatively small funds for providing this protection.

If your family fits into the early life cycle stages, here are some suggestions for getting the major protection you need with minimum expenditures.

What protection should you buy? The most important insurance need for most families is to insure the life of the sole or principal earner — usually the father. So take care of this need before you buy insurance for any other family member.

If burial expenses for the wife cannot be met out of current income, buy a $1,000 straight life policy on her life. If the wife works, your family might want to consider insuring against the loss of her income as well as against her death. Your family should also consider whether it can meet the cost of caring for the children out of current income if the mother were to die.

Look ahead to the protection you will want for the possible widow between the time the last child reaches 18 and the time when she is eligible for social security or other retirement benefits. The amount needed will of course vary with the individual ability and qualifications of the wife to support herself during this period.

Since the risk of the children's death is so small and they have no income to protect, consider buying insurance on them only after the parents are adequately protected.

What forms or types to buy? If you can qualify for group life insurance (including veterans' insurance), buy this form first. To keep the cost of your insurance at a minimum, buy term insurance with a renewable clause. Renewable term insurance, preferably for a decreasing amount, should serve your family quite well during this period, particularly if the need for income protection is quite large in relation to what you can pay. This type of insurance can also be used to provide the protection needed for the possible widow after the children reach 18.

To keep your insurance program flexible, consider buying several smaller policies rather than one or two large ones. By doing this, you can spread out the premium due dates and arrange them so that they are payable in months of lower family living expense.

While this will help to keep your program flexible, it may also add to the cost since most policies have a policy fee to cover the administrative costs of establishing the policy. You may be able to avoid some of the additional cost by paying each policy once each year. Premiums are often less if paid annually than if paid quarterly unless you have computerized billing as discussed on page 9.

Saving money. If your family is considering purchasing life insurance for the primary purpose of saving money, investigate other forms of savings. You will probably find that, rather than investing a given amount of money in endowment insurance over a given period of time, you will do better by buying U.S. Government savings bonds or by putting your money in a savings account (such as an insured bank or savings and loan association). In addition, you can purchase a term policy

to protect against loss of income. Protection is usually what a family needs most when the children are young.

If you set up an insurance program that provides for too much savings in relation to your protection needs, you may find your family in the same position as many others. They often must borrow on their policies when they reach a financial emergency, and then their protection is reduced or lost entirely. Our advice would be to set up separate systematic savings programs and protect your family income with term insurance of a renewable type.

High School and College Stages

The years when the children are in high school or college are good times to re-examine your family's needs for life insurance. Since the children will not be dependent many more years, you may want to change the kind or amount of protection you are carrying.

By the time the children are in high school, the mother may be working outside the home. She may therefore be in a better position to provide income for herself and the family if the husband should be disabled or should die. Any family's life insurance program should be re-examined whenever the wife enters or leaves the labor force in order to keep the family's economic security program up-to-date.

Recovery Stage

The recovery stage of the family life cycle is characterized by the financial independence of the children. The wife is usually the only dependent during this stage, and she may be in the labor force. If she is not working or cannot support herself, be sure that the wife is provided for in the period between the possible death of the husband and the time that she is eligible for social security or other retirement benefits.

Your family should make a special effort to build up savings for retirement during the recovery period. Put regular amounts into U.S. Government bonds, or into savings accounts in banks, savings and loan associations, or similar institutions.

Retirement Stage

When you reach retirement, your family's need for life insurance is usually much less than in former stages, especially if husband and wife are near the same age. The wife may be eligible for social security or other retirement benefits if the husband were to die. The family should consider whether these benefits will provide adequately for her living expenses.

During this period, some families purchase annuities which are the opposite of life insurance — they are used to insure against dying too

late and thus outliving your savings. If you plan to purchase annuities, save for them in a savings account in insured banks or savings and loan associations, not as part of your insurance, since often there is a heavy penalty for withdrawal. Buy your annuities when you are ready to retire, and pay for them with a lump sum.

REGULATION OF INSURANCE

In Illinois, the Department of Insurance is responsible for regulating the insurance industry. Before a company can sell insurance in Illinois, the company must be licensed by the Department of Insurance. This includes companies that maintain offices and agents in the state as well as companies that sell mail-order insurance in the state. Insurance agents, brokers, and solicitors working in the state must also be licensed by the Department before they can represent a company. Each company's assets, claim payment records, agents, and general practices are examined at regular intervals to insure that the company is continuing to do business in a reputable way. The various policy forms used by companies throughout the state must be approved by the Department.

The Department also maintains a consumer complaint division. This division will handle any complaint you have about an insurance company in Illinois. This might be a problem with unpaid claims, questionable practices of a company or agent, or any other problem you have with an insurance agent or company. If you need the help of the Department of Insurance, write to: The Department of Insurance, 525 West Jefferson Street, Springfield, Illinois 62706 or 1600 State of Illinois Building, Chicago, Illinois 60601.

KEEP YOUR INSURANCE PROGRAM EFFECTIVE

When life insurance is used to meet the changing needs of your family across the family life cycle, as discussed in this circular, it can be one of the most important parts of your family's economic security program.

Your family should consider the various types of life insurance policies available to meet your needs. Then, before you buy, check the cost and features of policies from different companies. Also, read the policy before you purchase it to be certain that it includes everything for which you have asked.

Every two or three years it is a good idea to look over the amount of insurance protection you have to see if your insurance needs have changed. Check to see that additional members of the family are protected, if your life insurance program calls for this protection. Be sure the beneficiaries you want are the same as those named two years earlier.

It is a good plan to keep your insurance policies in a place where your beneficiaries can locate them easily in the event of death. To speed up the settlement of the policies, the name of the agent to notify in the event of death could be attached to the policy. If your policies are stolen or lost or destroyed by fire, you can ask your insurance company to issue duplicates. There is no risk if you lose the policies, since they are of value only to the family. Keep a list of the policy numbers in a different place than where you keep the policies, so you can get duplicates easily.

Always let your insurance companies know when you are changing your address, so your premium notice will not get lost. Some types of policies expire and your protection stops if you do not pay your premium on time.

In general, your family gets no more than it pays for when buying life insurance. By careful planning, however, you may get more insurance protection at the time you need it most without increasing dollar expenditure for premiums. It is up to your family to build a program to meet your changing life insurance needs.

LIFE INSURANCE TERMS

Beneficiary — the person named in a life insurance policy to receive the face value if the insured dies.

Cash Value — the amount of money that a straight life insurance policy accumulates as the policy matures.

Convertible Clause — a clause that gives the policyholder the right to convert term insurance to straight life or some other permanent insurance plan.

Decreasing Term — a type of term insurance in which the amount of insurance decreases according to a specified schedule. This type of policy is often used for insuring home mortgages.

Disability Clause — a clause that allows for a waiver of premiums if the policyholder becomes permanently disabled or unable to work.

Dividend — the amount you are paid each year if the company collects more premiums than is necessary to meet its expenses, death benefits, and reserve build-up. Part of your premiums are returned as dividends.

Face Value — the amount stated on the life insurance policy that would be paid if the insured died.

Guaranteed Insurability Clause — a clause which guarantees the policyholder the right to purchase stated amounts of additional life insurance at specified times in the future without passing a physical exam.

Maturity — when the life insurance policy is paid-up and worth the face value.

Mortality Table — a table which lists the average length of life for a group of persons at any particular age.

Nonparticipating Insurance — life insurance that is calculated as close as possible to actual cost so no dividends are paid policyholders.

Paid-up Policy — a life insurance policy upon which all required premiums are paid.

Participating Insurance — life insurance that pays dividends to the policyholders (see Dividend).

Policy Fee — a flat charge to cover the administrative costs of establishing the policy. The fee does not change with the amount of the policy and is sometimes referred to as a quantity adjustment fee or quantity discount factor.

Policy Loan — a loan made to a policyholder for a proportion of the cash value of the policy.

Premium — the amount of money paid by the policyholder at regular intervals to keep his policy in force.

Renewable Clause — a clause which gives the policyholder the right to renew his policy without a medical examination for another period of time.

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